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In The  
**Supreme Court of the United States**  
October Term, 1995

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BARBARA SMILEY,

*Petitioner,*

v.

CITIBANK (SOUTH DAKOTA), N.A.,

*Respondent.*

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**Petition For A Writ Of Certiorari  
To The California Supreme Court**

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**PETITION FOR A WRIT OF CERTIORARI**

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## QUESTIONS PRESENTED

1. Did Congress intend South Dakota's legislative definition of "interest" to define the federal term "interest" in Section 30 of the National Bank Act, 12 U.S.C. § 85 ("§ 85"), and thereby displace other states' contract laws limiting the form or the amount of liquidated damages for late payments on revolving credit accounts?

2. May Congress constitutionally delegate to South Dakota the power to define the federal lending term "interest" for all fifty states so as to preempt other states' contract laws?

3. As a matter of federal law, does the term "interest at the rate" in § 85 include contingent, sum-certain penalty charges (late fees), so as to preempt state limitations on the form or the amount of contractual liquidated damages on revolving credit accounts?

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Barbara Smiley respectfully petitions for a writ of certiorari to review the judgment entered below by the California Supreme Court. Based on its reading of *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978), the California Supreme Court held that the lawfulness of Citibank's loan charges has been entrusted to the bank's home state so that the laws of South Dakota operate to preempt conflicting California contract laws limiting liquidated damages on credit cards held by California residents.

## OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court (App. 1-72) are published at 11 Cal. 4th 138, 44 Cal. Rptr. 2d 441, 900 P.2d 690 (1995). The majority and dissenting opinions of the California Court of Appeal (App. 74-98) are published at 26 Cal. App. 4th 1767, 32 Cal. Rptr. 2d 562 (1994). The opinion of the California Superior Court (App. 99-105) is unreported.

## JURISDICTION

The California Supreme Court entered its judgment (App. 1-72) on September 1, 1995. Petitioner invokes this Court's jurisdiction under 28 U.S.C. § 1257(a).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Article I, section 1 of the United States Constitution directs, in pertinent part, that "[a]ll legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. art. I, § 1.

The Supremacy Clause provides:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the

Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const. art. VI, cl. 2.

The Full Faith and Credit Clause requires, in relevant part, that "Full Faith and Credit shall be given in each State to the public Acts, Records, and Judicial Proceedings of every other State." U.S. Const. art. IV, § 1.

Section 30 of the National Bank Act, as codified at 12 U.S.C. § 85, provides, in pertinent part:

Any [national bank] may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State, . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under state laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. . . .

Prior to codification, Section 30 of the National Bank Act also provided what is now codified, in pertinent part, in 12 U.S.C. § 86:

The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action on debt, twice the amount of the interest thus paid. . . .

The California Civil Code section 1671 states, in relevant part:

(b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.

(c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:

(1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or

(2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.

(d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

### STATEMENT

The California Supreme Court held that the law of a bank's home state, in this case South Dakota, provides the definition of "interest" in § 85 and serves to preempt California's regulation of liquidated damages for a breach of a credit card contract held by a California consumer. Can South Dakota enlarge the definition of a federal term

in a federal statute and thereby determine and expand the scope of federal preemption? Can one state preempt without limitation the consumer protection and contract laws of all the other states? These are fundamental constitutional questions that should be addressed by this Court.

### A. Background and Facts

This case challenges the expansive reading of § 85 of the National Bank Act adopted by a divided California Supreme Court. Congress passed the National Bank Act in 1864 against the backdrop of the Civil War. The Act had two purposes – to establish a national banking system with a uniform national currency and to prevent states from discriminating against national banks. To prevent discrimination, Congress crafted into the Act a number of protective provisions,<sup>1</sup> including, most notably, § 30,<sup>2</sup> now codified as § 85 and 12 U.S.C. § 86 (“§ 86”). Section 85 embodies the “most favored lender” doctrine enunciated by this Court in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874). The doctrine allows a national bank to charge the highest “rate” of “interest” allowed by its home state. Section 85 also provides an alternative federal interest rate not measured by state law and permits a national bank to charge whichever of the two interest rates is higher. Section 86 then provides the penalty (twice the amount of interest charged) applicable in the event the bank charges more than the allowed rate.

<sup>1</sup> For example, to prevent states from passing discriminatory contract laws that might prevent a national bank from entering into contracts on terms as favorable as those of other businesses, Congress enacted § 24 (Third) of the Act, 12 U.S.C. § 24 (Third). That statute provides the general contracting powers of national banks. See *Anderson Nat'l Bank v. Lockett*, 321 U.S. 233, 239, 247-53 (1944) (upholding non-discriminatory state escheat statute).

<sup>2</sup> Act of June 3, 1864, Ch. 106, § 30, 13 Stat. 108 (1864), as amended and codified in 12 U.S.C. §§ 85 & 86 (1982).

Congress enacted these provisions intending the term “interest” to have a firm, federal definition that would not depend on unique state definitions. See *Tiffany*, 85 U.S. at 410 (holding that “interest” must “receive a strict, that is literal construction” to avoid subjecting banks to the penalty of double the interest collected). Although the arithmetic limit of the allowed rate of interest could vary from state to state, the meaning and substantive components of “interest” for national banks would be uniform throughout the country. In other words, the federal law incorporates only the rate ceilings of a bank’s home state, not the varying definitions of the states. See *National Bank v. Johnson*, 104 U.S. 271, 277 (1881) (construing *Tiffany* and holding that only the “rate” of interest is federalized by § 85, not the character of the contracts banks are authorized to make (emphasis in original)).

Years later, this Court, in *Marquette*, considered the meaning of the word “located” in § 85 and the preemptive scope of the statute. See 439 U.S. at 313-19. Announcing what has become known as the “exportation” doctrine, the Court held that “located” has a firm, federal definition so that a national bank may “export” its home state’s interest rate into other states. See *id.* The Court did not, however, define the terms “interest” or “rate,” nor did it hold that the laws of a national bank’s home state govern all the contractual terms or charges (other than “interest” as defined by Congress) imposed on consumers in other states.

Since *Marquette*, several small states (the “bank friendly states”) and numerous banks have attempted to expand the “exportation” doctrine beyond the parameters established by this Court and Congress. During the 1980s, some of those states, most notably South Dakota, the current home of Citibank (South Dakota), N.A. (“Citibank” or “the bank”), and Delaware, sought to attract large credit card operations by deregulating banking and repealing consumer protection laws. See Federal Reserve

Bank of Chicago, "Small States Teach a Big Banking Lesson," *Chicago Fed. Letter*, No. 10 (June 1986).<sup>3</sup> Against the backdrop of *Marquette*, those states passed unique legislation that, contrary to the common law, defined "interest" as including late fees, attorneys fees and other contract terms and penalties. The idea was to allow national and other banks in those states to "export" the terms and penalties into other states under the guise of "interest," a prospect that goes well beyond the exportation allowed under *Marquette*.

The present case challenges the exportation of contract penalties by Citibank. From South Dakota, Citibank issues Visa cards and Mastercards to customers nationwide. (App. 110). Citibank charges these customers not only a hefty annual percentage rate, but also a separate and additional \$15 late charge if a specified minimum payment is not received within a certain number of days after the payment due date. Citibank charges the \$15 flat fee regardless of the outstanding balance, the amount of the payment owed, or the actual number of days the

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<sup>3</sup> The bank friendly states' efforts to entice credit card issuers to relocate from other states have been wildly successful. See *Chicago Fed. Letter*, *supra*. Today, of the top ten issuers, six are located in Delaware, while a seventh, Citibank, the single largest issuer of Visa cards and Mastercards, is located in South Dakota. To keep even more card issuers from relocating to these deregulated states, other states have been forced to relent and repeal consumer protection statutes limiting penalty charges and other non-interest fees. See *id.* As this race to the bottom has unfolded, more and more consumers have lost the ability to effect legislative checks on oppressive or unfair contract terms. If the federal term "interest" means "all lending terms," as Citibank has argued, and if only the laws of a bank's home state may define and regulate those lending terms, then § 85 has pitted state against state, making it politically impossible, as a practical matter, for citizens to effect legislative change on the local or even the national level.

payment is late. (App. 114). In addition, Citibank's cardmember agreement treats the late payment as a technical breach of the contract and does not waive the default even if the late fee is paid. (App. 117 & 122). Bearing no relationship to the amount owed, the passage of time or the bank's loss resulting from a delay in payment, and imposed in addition to continuing finance charges, the late fee is a classic contract penalty that exceeds any reasonable provision for liquidated damages. (App. 114-115).

Citibank charges its late fees in every state, including those that prohibit or limit such liquidated damage provisions. California is one of the states that regulates contractual liquidated damages. Here, Citibank exported its late fees into California and imposed them on Petitioner Barbara Smiley ("petitioner" or "cardholder") and other California residents in violation of California law. In response, cardholder filed this consumer class action on July 7, 1992, on behalf of herself and all other California residents who have been charged late charges on credit cards issued by Citibank.<sup>4</sup> (App. 106-128).

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<sup>4</sup> Cardholder's complaint alleges that Citibank's \$15 late fee is a grossly excessive penalty that violates California's prohibitions against (1) excessive liquidated damage contract provisions (*i.e.*, unlawful penalties), California Civil Code § 1671; (App. 121-122); (2) unlawful, fraudulent or unfair business acts or practices (App. 118-120); (3) breaching the duties of good faith and fair dealing (App. 120-121); (4) unjust enrichment (App. 122-123); (5) fraud and deceit (App. 123-124); (6) negligent misrepresentation (App. 125); and (7) breach of contract (App. 125-126).

## B. How the Federal Question Was Presented and Resolved Below

After this case was removed to federal court and then remanded back to the California Superior Court,<sup>5</sup> Citibank presented the federal question in moving for judgment on the pleadings. Relying primarily on *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818 (1st Cir. 1992), reversing 776 F. Supp. 21 (D. Mass. 1991), cert. denied, 113 S. Ct. 974 (1993), Citibank contended that California law regulating penalty charges is preempted by § 85. The trial court, on July 6, 1993, denied the bank's motion. Citibank then petitioned the state court of appeal for a writ of mandate. After the court of appeal issued an alternative writ, the trial court, on September 14, 1993, entered a minute order dismissing cardholder's complaint. (App. 99-105).

Cardholder filed a notice of appeal on September 23, 1993. Following briefing and oral argument, the court of appeal, by a two-to-one majority, affirmed the trial court. The court of appeal concluded that "the late charges here are governed solely by 12 U.S.C.A. § 85 and § 86," and that "California law purporting to regulate such charges is preempted." (App. 84). Justice Johnson of the court of appeal dissented. He reasoned that the majority, and the authority on which it relied, "neglect[ed] a vital distinction between the payments and fees defined as 'interest' . . . and the family of costs and consequences of which 'late payment fees' are a member." (App. 95). On August 22, 1994, cardholder petitioned the California Supreme Court to review the court of appeal's ruling. The court granted review on October 27, 1994. (App. 73).

<sup>5</sup> On August 5, 1992, Citibank, asserting diversity jurisdiction, removed the action to the United States District Court for the Central District of California. Cardholder then moved to remand the case back to state court, and the federal court granted that motion. *Smiley v. Citibank (South Dakota)*, N.A., 863 F. Supp. 1156 (C.D. Cal. 1993).

On September 1, 1995, the California Supreme Court, in a five-to-two decision, affirmed dismissal of the case. (App. 1-72). The foundation of the majority's analysis was essentially threefold. First, extending *Marquette* beyond its context and holding, the majority reasoned that § 85 entrusts the lawfulness of a national bank's loan-related charges exclusively to the bank's home state, notwithstanding the laws of any other state. (See App. 13). The issue for the majority, then, was the scope of the preemption under § 85. The scope of that preemption, the majority reasoned, turned on the meaning of "interest" in § 85. (App. 14).

Second, to define "interest," the majority purportedly looked to the meaning of the term when § 85 was enacted. Stating that the dictionary definition at that time was "compensation for the loan or use of another sum," or "compensation paid by the . . . debtor to the creditor for its use," the court speculated that such "interest" could include both "a periodic charge based on a percentage of a certain sum . . . payable absolutely by maturity" and "a late payment fee, payable contingently in the event of default." (App. 18-19). The court further speculated that a late payment fee could be calculated as either a periodic percentage charge or as a flat fee. (App. 19).

Third, the majority turned to the most favored lender doctrine which, as enunciated in *Tiffany*, precludes states from discriminating against national banks with respect to interest rates. The court expanded that doctrine beyond the "strict, that is literal construction" mandated by *Tiffany* to reach not just rates of interest measured by time and the balance owed, but also all of the lending terms allowed by a bank's home state:

Congress must have known that unfriendly state legislation could be predicated on measures other than differential provisions concerning periodic percentage charges payable absolutely by maturity. . . . Had Congress intended to limit protection, it would doubtless have

*made itself plain. It did not. Its silence is especially deafening. . . .*

(App. 24, emphasis added). The majority then concluded that the term "interest" in § 85 "should be construed to cover late payment fees, if such fees are allowed by a national bank's home state." (App. 25).

Two justices of California's high court dissented. Justice Arabian pounced on the majority's inference of Congressional intent. He noted that while Congress used the word "interest" in § 85 a total of four times, it used the word "rate" nine times – more than twice as often as the term "interest." (App. 45). Emphasizing that "'interest' does not appear in a single sentence of section 30 unaccompanied by the word 'rate'" (*id.*, emphasis in original), Justice Arabian concluded that Congress most likely had in mind a narrower definition of "interest" – "a sum linked to the lending of money calculated at a *rate* or a percentage of the loan over time." (App. 46, emphasis in original).

Citing *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992), Justice Arabian also noted that because exportation is a matter of federal preemption, if Congress's intent to preempt state regulation of late fees is less than "clear and manifest," there is no preemption. (App. 59). He argued that, here, Congress's intent to displace credit terms other than "interest" was far less than clear and manifest. He emphasized that national banks are not immune from basic conflicts of law principles and are governed in their daily course of business far more by state laws than the laws of the nation. (See App. 60). Since Citibank had not shown that application of California's liquidated damages law would in any sense "incapacitate" banks from carrying out their duties as federal instrumentalities, Justice Arabian would have held that § 85 did not preempt California's contract laws limiting late fees on credit cards. (App. 61).

Justice George separately dissented, observing that a late fee for a fixed sum, unrelated to the amount or time period of the loan, and assessed only if the borrower is

late with a payment, is a penalty at common law, not interest. (App. 65-66). Arguing that the same was true back in 1864, Justice George cited *Spain v. Hamilton's Administrator*, 68 U.S. (1 Wall.) 604, 626 (1863) and *Lloyd v. Scott*, 29 U.S. (4 Pet.) 205, 224 (1830), both of which made clear that a late fee, the payment of which was contingent upon the borrower's own conduct, would not be considered interest for the purpose of determining whether the loan exceeded the legally permitted interest rate. (App. 67-68).

Justice George also criticized the majority's most favored lender analysis. In the absence of § 85, he observed, a state still could not discriminate against a national bank. He reasoned that if § 85 were the sole impediment to discrimination – as assumed by the majority – then a variety of other matters subject to state regulation would have to be deemed "interest," such as building permits, minimum wages and health and safety requirements. (See App. 70). Justice George therefore rejected the majority's package preemption analysis because its anti-discrimination premise was without limit and would lead to absurd results. (See App. 71). Justice George would have held that § 85 was limited to "rates" of interest so that other lending terms could not be exported under the preemptive scope of "interest."

## REASONS FOR GRANTING THE PETITION

This Court should review and reverse the decision below because (i) it conflicts with a recent decision by the New Jersey Supreme Court on the very same federal issues involving the same practices of the same national bank, *Sherman v. Citibank (South Dakota)*, N.A., No. A-102-94, slip op. (N.J. Nov. 28, 1995) (App. 151-224); (ii) it conflicts with controlling decisions of this Court, including *Tiffany*; (iii) it endorses a form of state supremacy over other states; (iv) it reverses the presumption against preemption; and (v) it has immediate nationwide impact on states, consumers and national banks.

Besides conflicting with *Sherman*,<sup>6</sup> the California court's decision opens the door to limitless preemption of one state's laws by the laws of a sister state. Although the parties agree that the § 85 term "interest" may include a number of different types of charges irrespective of the form or the label, the term cannot be defined to include "all charges" allowed by a bank's home state. In the absence of a firm, federal limit on the meaning of "interest," as required by *Tiffany*, § 85, as interpreted by the lower court, would improperly empower one state to overrule the conflicting public policy decisions of all the other states.

To be sure, "interest" in § 85 may include "damages" paid after a loan default, such as back-end charges to compensate the lender for the time value of its money. Those "damages" that are based on an unpaid balance and measured by time may be interest in the "nature of damages." But contingent sum-certain charges like credit card late fees, attorneys fees, return check fees and over-limit fees are not "interest in the nature of damages" because they are neither based on the unpaid balance nor measured by time. See *Meilink v. Unemployment Resources Comm.*, 314 U.S. 564, 570 (1942) (the distinction that a "penalty is a fixed ad valorem amount taking no account of time, and interest which does depend on time, is persuasive."). These two important features (based on the unpaid balance and measured by time) are prominently identified in the legislative record accompanying the National Bank Act,<sup>7</sup> but were overlooked by the majority below.

<sup>6</sup> In a companion case, the New Jersey Supreme Court also rejected federal preemption with respect to credit card late fees charged by federally insured state banks. *Hunter v. Greenwood Trust Co.*, No. A-103-94, slip op. (N.J. Nov. 28, 1995) (App. 129-150).

<sup>7</sup> See, e.g., Cong. Globe, 38th Cong., 1st Sess. 1353 (1864) (Rep. Cole of California: "In California, the interest is by law, where no rate is expressed in the contract, ten percent per

Although "interest in the nature of damages" may take many forms, for a charge to constitute a "rate" of interest within the meaning of § 85, there must be some connection between the amount of the charge and both the delay time and the unpaid balance. Where a sum-certain default charge is contingent (not required for the loan or forbearance) and is not related to time or the unpaid balance (not a ratio charge), it is a contract penalty rather than "interest in the nature of damages." This Court has often recognized this distinction. See *United States v. Childs*, 266 U.S. 304, 307 (1924) ("[a] penalty is a means of punishment; interest a means of compensation"). At common law, in fact, penalty charges were against public policy and unenforceable. *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 226 (1930) ("But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced"). The decision below conflicts with these common law principles and improperly allows one state's legislative decisions to preempt the contract laws of other states.

#### A. The California Supreme Court's Decision Conflicts with the New Jersey Supreme Court's Decision on the Very Same Federal Issues.

As noted, the California decision conflicts with the New Jersey Supreme Court's recent decision in *Sherman*, which involved the same practices of the same bank and the same federal preemption issues. (Contrast App. 1-41 with App. 151-190). Disagreeing with the majority opinion of the California court, and citing instead Justice Arabian's dissent, New Jersey's high court declined to define "interest" in § 85 based on South Dakota law. (See App. 167). Instead, the New Jersey Supreme Court held

annum"); Cong. Globe, 38th Cong., 1st Sess. 1374 (Rep. Kasson of Iowa: "In my own State, sir, we allow a rate of interest of ten percent per annum.").

that late fees are not "interest" under the federal statute and that § 85 therefore does not preempt state regulation of late fees. (See App. 154).<sup>8</sup>

Because two state supreme courts have decided the same federal issues oppositely, there is a direct and substantial conflict that should be resolved by this Court.<sup>9</sup> In addition, numerous other cases involving the very same issues are pending nationwide and have resulted in additional conflicts.<sup>10</sup> These conflicts cannot be resolved by

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<sup>8</sup> In so holding, the New Jersey court specifically criticized the California court's decision. While the California court reasoned that the historical legal usage of "interest" included late fees, the New Jersey court concluded that, in fact, "interest" historically has been limited to a periodic charge expressed as a percentage of the principal balance due. (App. 169). The New Jersey court also disagreed with the California court's assumption that if "interest" did not include late fees a state could discriminate against national banks. Noting that federal law has long prohibited state discrimination against federal instrumentalities, the New Jersey court concluded that "the most-favored lender doctrine serves to eliminate discrimination without distorting or extending the meaning of interest to include charges that Congress neither expressly nor implicitly incorporated in the definition of 'interest.'" (App. 170).

<sup>9</sup> A third state supreme court also has contributed to the conflict. In *Copeland v. MBNA America, N.A.*, No. 94SC409, slip op., 1995 Colo. LEXIS 743 (Colo. Nov. 20, 1995), the Colorado Supreme Court recently appeared to follow the California Supreme Court, holding that Colorado law has been displaced by the law of the bank's home state, in that case, Delaware. Slip op. at 6, 1995 Colo. LEXIS 743 at \*5-\*6. The Colorado court apparently misunderstood this Court's preemption principles, stating that preemption analysis was not necessary because federal law had only an "incidental" impact on Colorado law. See *id.* slip op. at 5-6, n. 4. Nevertheless, the Colorado court found Colorado law inoperative. See *id.* slip op. at 6.

<sup>10</sup> In Pennsylvania, the intermediate appellate court, like the New Jersey Supreme Court, ruled in favor of the cardholders in two cases, finding no preemption of state law.

any other court and will result in different federal preemption standards for the same practices and the same parties in different parts of the country. This Court should grant certiorari immediately to resolve these and the other conflicts we detail below.

#### **B. The California Supreme Court's Decision Has Wide-Ranging and Dangerous Consequences.**

Apart from the conflict between state supreme courts, this case implicates important issues that go beyond the preemption questions typically confronted by this Court. Unlike any other preemption case decided by the Court, this petition challenges a holding that ties the scope of federal preemption directly to the ever-changing legislation of an individual state that is home to a national bank. If, as the California Supreme Court has held, South Dakota has been "entrusted" (App. 30) to define the components of the federal term "interest" in § 85, and not just the arithmetic "rate," then South Dakota's legislative definition of that term has displaced the contract laws of all the other states. Under the ruling below, the breadth of preemption intended by Congress will be determined not by federal law but by state law, so that it may vary from state to state and time to time.

The California Supreme Court in effect has endorsed a radical preemption doctrine unknown to any other

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*Mazaika v. Bank One, Columbus, N.A.*, 439 Pa. Super. 95, 653 A.2d 640 (1994) (*en banc*), alloc. granted, 659 A.2d 557 (Pa. May 25, 1995); *In re: Citibank (South Dakota) Credit Card Litigation*, 439 Pa. Super. 79, 653 A.2d 39 (1995), alloc. granted, 659 A.2d 984 (Pa. May 31, 1995). The Pennsylvania Supreme Court has granted discretionary review in both cases. Also, an appeal concerning many of these same issues has been argued before the United States Court of Appeals for the Third Circuit. *In re Consolidated Credit Card Appeals*, Nos. 94-3203/04, 94-3215/16/17/18 (3d. Cir. appeal pending). Having argued the appeals on February 2, 1995, the parties to that litigation are waiting for the court's decision.

federal statute. By allowing federal preemption to operate "as by a [federal] choice-of-law provision," (App. 30), the lower court has adopted a form of state supremacy over other states unconfined by any federal standards limiting the preemptive actions of the favored states. If a bank's home state authorizes any loan-related fee or term, that authorization will preempt other state laws where the banks are soliciting business. In this way, the California decision has allowed Congress to make the home states of banks supreme to all others.

This is so because the driving force behind the majority opinion is a misconstruction of the "most favored lender" doctrine. Reading that doctrine expansively, the lower court has held in effect that all loan-related charges or terms must be "interest" if they are allowed for other lenders in a bank's home state. Under that analysis, attorneys fees, court costs, foreclosure fees and other default penalties would be federalized "interest" if allowed by a bank's home state. Thus, the home states of banks can preempt countless laws of other states simply by connecting their loan-related authorizations to the "interest" allowed in the home state, as South Dakota has done here.

1. In this respect, the lower court's judgment conflicts with *New York Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 115 S. Ct. 1671 (1995), where this Court rejected the very type of "package" preemption adopted by the majority below. In *Travelers Ins. Co.*, this Court considered whether certain state surcharge laws that had an "indirect economic effect on the relative costs of various health insurance packages" were related to employee benefit plans so as to be preempted by federal ERISA law. *See id.* at 1679-81. Like Citibank below, the commercial insurers argued that the surcharge laws could impact on the attractiveness of their benefit packages and "preclude a uniform interstate benefit package." *Id.* at 1679. Unlike the California court below, however, this Court categorically rejected those economic package preemption arguments. *Id.* at 1683. As in Justice George's

dissent, this Court observed that even basic state regulation of employment conditions could affect the cost and price of ERISA services. *See id.* at 1679-80. The Court then held that such indirect effects did not give rise to a conflict between state and federal law so as to preempt state law. *Id.* at 1680.

Here, too, the indirect economic effects of state limitations on charges like late fees, return check fees, attorney fees and even court costs do not make those fees "interest" and thereby preempt the laws of a borrower's state. If indirect economic effects were sufficient, the preemptive scope of § 85 would be limitless and entirely dependent on the laws of a bank's home state. But this Court has made clear that federal law, not state law, defines the scope of the term "interest" in § 85.

2. The decision below therefore conflicts as well with this Court's controlling decisions interpreting § 85. In *Haseltine v. Central Bank of Springfield*, 183 U.S. 132 (1901), the Court held that "the definition of usury and the penalties affixed thereto must be determined by the national banking act, and not by the law of the state." *Id.* at 134. Similarly, in *Evans v. National Bank*, 251 U.S. 108 (1919), the Court recognized that both "interest" and "usury" are determined by reference to federal law, stating:

The maximum interest rate allowed by the Georgia statute is 8 per centum. That marks the limit which a national bank there located may charge upon discounts; but its right to retain so much arises from federal law. The latter also completely defines what constitutes the taking of usury by a national bank, referring to the state law only to determine the maximum permitted rate.

*Id.* at 114 (emphasis added). The holding of the court below implicitly rejects these controlling authorities.<sup>11</sup>

3. This Court should address these conflicts immediately because the California decision endorses a dangerous preemption theory that will impose unwarranted costs and uncertainty on consumers, states, banks and lower courts for years to come. In incorporating South Dakota's definition of interest into § 85, the lower court utterly failed to recognize that Congress has never incorporated state law without limitation into a federal statute so that the state's law would preempt other states' laws. Congress instead has limited incorporation to well-defined areas where the state standard would operate principally if not exclusively within the boundaries of the state itself, not in other states. *See, e.g., United States v. Sharpnack*, 355 U.S. 286 (1958) (addressing Assimilative Crimes Act of 1948, which adopted state law as the federal criminal law for military bases and federal enclaves located in each particular state).

This case is not one in which the incorporation of South Dakota law affects only South Dakota. The California court's ruling that South Dakota has been "entrusted" to define "interest" in § 85 leads to the absurd and unconstitutional result that Congress has authorized South Dakota to legislate federal lending terms for the entire country. The Constitution does not allow Citibank to define federal law with reference to its own state's laws and thereby elevate South Dakota law over the laws

<sup>11</sup> Quoting *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185 (1873), the California Supreme Court observed that "'Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money or as damages for its detention.'" (App. 18). In *Brown*, however, the detention damages were (i) based on an unpaid balance and (ii) measured by time. No case before 1992 has held that "interest" may include a detention charge that is not based on the unpaid balance and measured by time. Accordingly, *Brown* does not support the conclusion that sum-certain contingent penalties are "interest."

of California and other states. Nor can the states constitutionally enlarge or diminish the scope of federal preemption by redefining the federal term "interest." "To vest the power of determining the extraterritorial effect of a State's own laws and judgments in the State itself risks the very kind of parochial entrenchment on the interests of other States that it was the purpose of the Full Faith and Credit Clause and other provisions of Art. IV of the Constitution to prevent." *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980).

4. The lower court's decision also conflicts with this Court's anti-delegation precedents. Article I, section 1 of the Constitution provides that "[a]ll legislative powers . . . shall be vested in a Congress of the United States." U.S. Const. art I, § 1 (emphasis added). If the scope of "interest" in § 85 is determined by the law of a bank's home state, as held below, then Congress's delegation of such legislative authority to South Dakota violates Article I.

This Court's decision in *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935), demonstrates the point. In that case, the Court described the standards for delegating congressional power and struck down a statute that delegated interstate policy-making authority to the President, who then adopted state laws as the operative restrictions. In rejecting the open-ended delegation, the Court focused on the absence of any guidelines limiting the scope or nature of the delegated authority:

[The statute] does not seek to lay down rules for the guidance of state Legislatures or state officers. It leaves to the states and to their constituted authorities the determination of what production shall be permitted. It does not qualify the President's authority. . . . It establishes no criterion to govern the President's course. It does not require any finding by the President as a condition of his action.

*Id.* at 415. The Court also found that the context of the statute failed to provide any "standard or rule" against

which the delegated authority could be measured. *Id.* at 418.

Here, delegation to South Dakota of the legislative power to define the federal term "interest" likewise fails. The decision whether "interest" includes liquidated damages, attorneys fees, court costs or other contractual penalties is "quintessentially one of legislative policy" that should be made by Congress, not by an individual state legislature that is unaccountable to the will of the nation. See *Industrial Union Dept. v. American Petroleum Inst.*, 448 U.S. 607, 686 (1980) (Rehnquist J., concurring). Furthermore, neither the word "interest" nor the legislative history of the National Bank Act, as interpreted by the lower court, provides any guidance to the states or to a reviewing court as to the scope of the word or the limits of the delegated discretion. As construed by the lower court, Congress has provided no definition, established no standard, laid down no rule and declared no policy separate from that of the individual states and, therefore, the delegation is unconstitutional.<sup>12</sup> *Panama Refining*, 293 U.S.

<sup>12</sup> To be sure, *Marquette*, in effect, permits a bank's home state to establish "interest rates" that are controlling in other states. But that result does not amount to a limitless delegation of Congress's lawmaking authority. The federalization of a time-based "rate" or required charge for a loan is bounded and checked by the firm, federal definition of "interest" advanced by petitioner but rejected by the majority below. With that definition, it would be easy to determine whether a home state's "rate" comported with the will of Congress. If, however, as the California court has held, South Dakota can broaden the meaning of "interest" so as to determine what credit terms are lawful, then South Dakota would be engaged in lawmaking for the entire nation. As here, South Dakota would be defining not just an arithmetic rate, but also the actual rights and liabilities (e.g., what does "late" mean; are attorneys' fees collectible) affecting citizens of other states. Nothing would stop South Dakota from defining "interest" to include attorneys fees, court costs, foreclosure costs, collection costs or any other loan-related term that

at 430 ("The Congress manifestly is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested"); *Industrial Union*, 448 U.S. at 646 (plurality opinion) (construing statute so as to avoid open-ended delegation of legislative power).<sup>13</sup>

To allow South Dakota to define "interest" in § 85 and, in turn, the preemptive scope of the statute, is to allow that state to substitute its will for the will of Congress. Residents of California and other affected states have no voting opportunity to influence the legislators in South Dakota. Absent accountability, the delegation by Congress inferred by the lower court would constitute a serious violation of the principles embodied in Articles I

might arguably impact a lender's total return on its loans. Congress could not have intended to delegate its national lawmaking power in such a manner.

<sup>13</sup> Only Congress has open-ended discretion to choose the object and ends of national legislation. See L. Tribe, *American Constitutional Law* § 5-17 at 363 (2d ed. 1988). Congress may not authorize individual states to choose between different legislative needs or to substitute the will of a state legislature for that of Congress where such state decisions will have an impact nationally or on residents of other states:

Congress cannot simply delegate to the states the power to legislate in areas that are reserved to Congress – e.g., powers under the interstate commerce clause – but Congress may by federal legislation adopt and incorporate by reference state laws that already exist or that may exist in the future. For example, Congress cannot delegate to Illinois the power to legislate federal pollution standards for the whole country. Then Congress would be abdicating interstate commerce control to one state to legislate for the entire nation.

1 R. Rotunda, J. Nowak, J. Young, *Treatise on Constitutional Law – Substance and Procedure*, § 12.6 at 644 (1986) (emphasis added). See also *Yakus v. United States*, 321 U.S. 414, 425-26 (1944).

and IV of the Constitution. Cf. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963).<sup>14</sup>

Unless § 85 is read with reference to the common law so as to exclude late fees from the definition of "interest," each state could give a different meaning to the term. Each state, by making "interest" mean whatever it wanted, could determine the scope of federal preemption and extend its own lending laws into other states without limit. This Court has recognized that danger before. In *First Nat'l Bank v. Dickinson*, 396 U.S. 122 (1969), the Court considered whether federal or state law defined the term "branch" in the National Bank Act. The Court stressed that permitting state legislatures to define the federal term "branch" would "make them the sole judges of their own powers," and that Congress "did not intend such an improbable result." *Id.* at 133-34. Here, too, Congress did not intend for South Dakota to define the scope of federal preemption and thereby be the sole judge of its own power. The California Supreme Court's ruling conflicts with these principles and should be reviewed immediately.

**C. The California Supreme Court's Decision Flips the Presumption Against Preemption, Misconstrues the Most Favored Lender Doctrine and Improperly Expands the Common Law Definition of "Interest."**

1. Besides affecting numerous consumers and the fifty individual states, the California Supreme Court's decision conflicts with even the most basic preemption

<sup>14</sup> In *Florida Lime*, this Court refused to find a California law preempted where residents of that state had no real opportunity to participate in the process that resulted in the federal regulation that allegedly superseded California's law. Here, too, California residents have had no opportunity to participate in the process that has allegedly resulted in South Dakota law preempting California law.

principles. As this Court has held time and again, there is a strong presumption *against* federal preemption of state law. See *Maryland v. Louisiana*, 451 U.S. 725, 746 (1981). As a result of that presumption, "the historic police powers of the States [are] not to be superseded by . . . [a] Federal Act unless that [is] the *clear and manifest purpose* of Congress." *Cipollone v. Liggett Group, Inc.*, 505 U.S. at 516 (plurality opinion) (emphasis added) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Unless a state law "incapacitates the [national] banks from discharging their duties to the government," there will be no preemption. *McClellan v. Chipman*, 164 U.S. 347, 357 (1896).

Here, the California Supreme Court reversed the presumption against preemption. Though recognizing that there were no clear statements in the statute or the legislative history of Congressional intent to preempt state regulation of liquidated damages on revolving credit accounts, the court held that such silence demonstrated Congress's intent to preempt. (See App. 24). According to the court below, whenever Congress enacts a federal statute, it intends to preempt state law unless it specifically states otherwise. (See *id.*). That analysis directly conflicts with the standards set forth in *Cipollone*, *McClellan* and dozens of other decisions by this Court.

Contrary to the lower court's decision, *Marquette* does not support an expansive reading of federal preemption principles. *Marquette* established a firm, federal definition of the word "located" in § 85 and held only that a national bank may export its home state's *rate* of interest. See 439 U.S. at 313-14. Since South Dakota's definition of the components of interest has nothing to do with the unlimited *rate* at which interest is allowed in that state, *Marquette* provides no basis for exporting South Dakota's definition of interest. Citibank may still charge the unlimited rates allowed by its home state when it solicits consumers in California and other states. It may not, however, impose a separate, sum-certain penalty fee which is neither a "*rate*" based on time and the balance

owed nor "interest." Because California law does not limit the amount of Citibank's "interest rates," but only the form of Citibank's non-interest charges, it does not conflict with § 85.<sup>15</sup>

2. In contrast, the lower court's decision does directly conflict with the common law interpretation of federal statutes mandated by this Court. This Court recently reaffirmed that strong presumption of a common law meaning in *United States v. Texas*, 113 S. Ct. 1631 (1993). In that case, which likewise considered the meaning of "interest" in a federal statute, the Court instructed:

"[s]tatutes which invade the common law . . . are to be read with a presumption favoring the retention of long-established and familiar principles". . . . In such cases, Congress does not write upon a clean slate. . . . In order to abrogate a common law principle, the statute must

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<sup>15</sup> The majority's decision also incorrectly relies on the observation in *Marquette* that " 'individuals were always free to visit neighboring states and receive credit at foreign interest rates.' " App. 13 and 38, quoting *Marquette*, 439 U.S. at 318. *Marquette* did not suggest, however, that individuals would be required to submit to another state's definition of the federal term "interest" when the borrowers have not even visited the other state or received notice of a definition that conflicts with the ordinary, common sense meaning of "interest." While federal law may provide reasonable notice that the usury ceilings of a borrower's state will not apply in transactions with out-of-state banks, it does not provide notice that fundamental contract, judgment collection and common laws of the borrower's state may also be supplanted by the bank's home state. Without such notice, California consumers who have not visited South Dakota cannot be held to have surrendered the contract rights and protections lawfully enacted by their own elected representatives. "For such Kafkaesque nonsense, We The People will require a new Constitution." *Irwin v. Citibank (South Dakota)*, N.A., 26 Phila. 388, 394 (Phila. Ct. Common Pleas, 1993), *aff'd*, 439 Pa. Super. 79, 653 A.2d 39 (1995), *alloc. granted*, 659 A.2d 984 (Pa. May 31, 1995).

"speak directly" to the question addressed by the common law.

113 S. Ct. at 1634 (citations omitted); see also *United States v. Shabani*, 115 S. Ct. 382, 384 (1994). The Court also distinguished between interest and penalties (including late fees) and found that penalties are "more onerous than the common law" of prejudgment interest. 113 S. Ct. at 1635-36 ("Unlike the common law, § 3717 also imposes processing fees and penalty charges"). Penalties cannot be "more onerous" than interest if they are one and the same, as the California court incorrectly held below.

The lower court also erroneously assumed that Congress, by its silence, intended to change the common law when it used the word "interest" in § 85. See *id.* at 1634.<sup>16</sup> But because § 85 does not "'speak directly' to the question addressed by the common law," it does not abrogate the common law. *Id.* at 1634. Therefore, Congress must have intended that "interest" in § 85 be construed uniformly based on the ordinary, common law meaning of the term. See *Perrin v. United States*, 444 U.S. 37, 42 (1979).

Congress was fully aware of the ordinary, common law differences between late charges and interest when it

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<sup>16</sup> Although the lower court admitted that the common law definition of "interest" excluded penalty charges, it declined to apply a federal definition because the common law cases were not § 85 cases. (App. 32-34 & n.15). That illogical and confused reasoning cannot withstand scrutiny. If Congress does not define a term in a statute or the legislative history, the only other source to determine its meaning is the common law or common understanding. To determine the meaning of a newly enacted statute, a court must refer to analogous cases or sources which necessarily will not have addressed that statute in particular. Hence, the common law is the only guidance courts have in most cases.

passed the National Bank Act in 1864.<sup>17</sup> On at least three occasions before passage of the Act, this Court had already held that sum-certain contingent default charges, like late fees, were not "interest." For example, in *Tayloe v. Sandiford*, 20 U.S. (7 Wheat.) 13 (1822), the Court recognized that "[i]n general, a sum of money in gross, to be paid for the non-performance of an agreement, is considered as a penalty. . . ." *Id.* at 17. Later, in *Lloyd v. Scott*, the Court held:

If a party agree [sic] to pay a specific sum, exceeding the lawful interest, provided he do [sic] not pay the principal by a day certain, it is not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, which is considered as a penalty.

29 U.S. (4 Pet.) at 226 (emphasis added). Likewise, just one year before enactment of the National Bank Act, the Court had stated with respect to any contingent charge:

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<sup>17</sup> Even the context of the language demonstrates that Congress understood that "interest" is compensation related to the time value of money. Though § 85 permits a national bank to charge interest at the highest "rate" allowed to any lender in its home state, the statute does not authorize the bank to impose late fees or any type of lending charge other than an interest "rate." In fact, the term "rate" appears in the statute at least nine times, and it always refers to a charge that is related to the passage of time. In contrast, § 86 of the Act provides that where an excessive rate has been charged, the borrower may recover damages in an "amount" equal to twice the interest paid. Unlike the term "rate" in § 85, the term "amount" in § 86 refers to sum-certain damages or penalties that are totally unrelated to the passage of time. See *First Nat'l Bank of Charlotte v. Morgan*, 132 U.S. 141, 144-45 (1889) (§ 86 case where this Court recognized a material difference between compensatory "interest" and deterrent or punitive "penalties").

The payment of anything additional depends also upon a contingency, and not upon any happening of a certain event, which of itself would be deemed insufficient to make a loan usurious.

*Spain v. Hamilton's Adm'r*, 68 U.S. (1 Wall.) at 626. Because Congress also was well aware that "[t]he popular or received import of words furnishes the general rule for the interpretation of public laws," *Mcillard v. Lawrence*, 57 U.S. (16 How.) 251, 261 (1853), it must have used the term "interest" as it was understood at common law and common understanding to exclude contingent, sum-certain penalties imposed in addition to continuing finance charges.<sup>18</sup>

At common law, "special damages" that more than compensated a lender for the time-value of money were

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<sup>18</sup> Contrary to the majority opinion below, ancient and ecclesiastical law also shows that "interest" and sum-certain contract penalties are not the same. At Roman law, the only "interest" that was allowed was that measured by time following a default. In effect, "interesse" (interest) and penalties were the same. But the measure of the "interest" (then called penalty) was based on the unpaid balance and measured by time. Any greater amount was a classic contract penalty ("nomine paenoe") that was "relievable against in equity." See R. Comyn, *Treatise on the Law of Usury*, pp. 73-74 & n.(a) (R. Pheney, London 1817); see also *Library of Congress v. Shaw*, 478 U.S. 310, 315 n.2 (1986). Today, as in Roman times, "interest" following a loan default is likewise limited and must be measured by the "id quod interest" (that which is between) standard. See *Shaw*, 478 U.S. at 315 n.2. Although "interest" for a loan or forbearance is now allowed as well (at Roman times such interest was not lawful), the time measurement for default charges persists. See *id.* If a time measurement is absent, the default charge is a contract penalty or forfeiture because the amount is presumed to exceed the time value of money. See *Meilink*, 314 U.S. at 570; see also *Merchants' Nat'l Bank v. Sevier*, 14 F. 662, 663, 667-75 (C.C.E.D. Ark. 1882) (National Bank Act case surveying the differences between the common law of penalties and statutory usury principles).

prohibited. For example, in *Loudon v. Taxing District*, 104 U.S. (14 Otto) 771 (1881), a borrower defaulted, requiring the lender to sell his own assets at a substantial discount. The lender sued for the "costs" of the default. The issue was whether the borrower was liable for more than the time-value of the lender's money. This Court held that interest measured by time is the *only* damage allowed:

[A]ll damages for delay in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages.

*Id.* at 774 (emphasis added). See also *New Orleans Ins. Co. v. Piaggio*, 83 U.S. (16 Wall.) 378, 386 (1872) (a party "cannot recover special damages for the detention of money due to him beyond what the law allows as interest").

The majority below turned the reasoning of this common law upside down. Instead of holding that "interest" based on the unpaid balance and the passage of time is the "measure of all such damages," the California court found that additional, sum-certain "penalties" are the measure of all "interest." That holding completely disregards the guidelines established by this Court in *United States v. Texas*, *Taylor*, *Lloyd*, *Spain*, *Loudon* and *Piaggio*.

The California Supreme Court erred in holding that sum-certain contingent late fees imposed in addition to continuing finance charges are "interest" under § 85. Because that court's error adversely affects so many consumers and allows South Dakota's definition of "interest" to preempt all the other states' consumer protection laws, this Court should grant certiorari and correct the error.

#### D. The Court Should Review This Case to Provide Much Needed Guidance to States, Banks, Consumers and the Lower Courts.

The question of whether "interest" in § 85 can be defined by state law to include contract penalties is one of national importance to consumers, each of the states, and the national banks throughout the country. Back in 1992, Massachusetts and twenty-seven states asked this Court to review almost the exact same issues and to reverse a lower court decision finding preemption in *Massachusetts v. Greenwood Trust Co.*, 113 S. Ct. 974 (1993) (denying certiorari).<sup>19</sup> Though the Court declined to review the matter at that time, the controversy has not gone away. In fact, as already described, litigation is now pending nationwide.

The sheer number of cases as well as the conflicting opinions demonstrate the national significance of the issues and the urgent need for guidance from this Court. Until the Court decides the questions raised here, the controversy will continue, draining the pockets of consumers and litigants and the resources of the courts. To attract major credit card operations, state legislators will continue their race to the bottom in consumer protection by defining "interest" to embrace countless fees, including court costs and even attorneys fees. National banks located in those states will continue to export the contract penalties in violation of other states' laws, and consumers will continue to suffer from the unlawful practice.

Just as these issues have been deemed appropriate for review by four state supreme courts during the past year, they are even better suited for review by this Court.

<sup>19</sup> The only difference was that the *Greenwood* case involved the definition of "interest" in § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDA"), 12 U.S.C. § 1831d ("§ 521"). Section 521, modeled after § 85, applies to federally insured state banks instead of national banks.

Where, as here, there are unsettled issues of federal and constitutional law causing grave concern and expense to every state and to consumers nationwide, no individual state supreme court should have the last word. Because this case presents important and urgent questions of federal law, this Court should grant certiorari and decide the issues.

### CONCLUSION

The petition for a writ of certiorari should be granted.

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No. \_\_\_\_\_

In The  
**Supreme Court of the United States**  
October Term, 1995

BARBARA SMILEY,

*Petitioner,*

v.

CITIBANK (SOUTH DAKOTA), N.A.,

*Respondent.*

Petition For A Writ Of Certiorari  
To The California Supreme Court

APPENDIX TO  
PETITION FOR A WRIT OF CERTIORARI

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Filed 9/1/95 Banks and Bankruptcy

IN THE SUPREME COURT OF CALIFORNIA

BARBARA SMILEY,	)	
Plaintiff and Appellant,	)	S041711
v.	)	Ct.App. 2/7
	)	No. B078913
CITIBANK (SOUTH	)	
DAKOTA), N.A.,	)	L.A. Super. Ct.
	)	No. BC059202
Defendant and Respondent.	)	

We granted review in this cause – which is one of numerous similar matters brought in federal and state courts throughout the nation – in order to consider the meaning and effect of section 30 of the National Bank Act of 1864. In pertinent part and without substantive change, the provision has been incorporated in section 5197 of the Revised Statutes of 1878, and has been codified in section 85 of title 12 of the United States Code (hereafter section 85), which is its common designation. As relevant here, it provides that a national banking association, or more simply a national bank, “may take, receive, reserve, and charge on any loan . . . *interest* at the rate allowed by the laws of the State . . . where the bank is located. . . .” (Italics added.) Our question is, “May the term ‘interest’ be construed to cover late payment fees?” Our answer is, “Yes, if such fees are allowed by a national bank’s home state.”

## I

Plaintiff Darbara Smiley (hereafter Smiley) filed a complaint in the Superior Court of Los Angeles County against defendant Citibank (South Dakota), N.A. (hereafter Citibank). Smiley purported to proceed on behalf of herself and all others similarly situated – specifically, the class of persons “who held or currently hold a Citibank credit card . . . while they were residents of California and while they maintained a California billing address, and who have contracted for or been charged a late charge on such credit card account.” She alleged facts to the following effect: she was a resident of Los Angeles County; Citibank was a national bank chartered by the Comptroller of the Currency with its only address in Sioux Falls, South Dakota, and consequently located solely in that state; it issued credit cards under the “Visa” and “MasterCard” service marks; she held a Citibank “Preferred” Visa credit card and had held a Citibank Master Card credit card; as a condition of the extension of credit, Citibank “charges a late charge of up to \$15.00 upon California consumers who use its credit cards, irrespective of the outstanding balance or amount owing on the credit card in question,” when they do not timely make a minimum payment; she had been charged late payment fees by Citibank on both her Preferred Visa and her MasterCard credit card accounts. On the basis of such allegations, she attempted to state various causes of actions arising under California law, including statutes and common law, going ultimately to the amount of the late payment fees in question, and sought various forms of relief.

Citibank filed in the United States District Court for the Central District of California a notice of removal of Smiley’s action from state court to federal – its petition for removal. The sole ground on which it relied was diversity of citizenship – so-called “diversity jurisdiction” – under subdivision (a)(1) of section 1332 of title 28 of the United States Code, which requires not only that the parties are “citizens of different states” but also that the “matter in controversy exceeds the sum or value of \$50,000. . . .”

Subsequently, Citibank filed an answer in federal district court. One of the affirmative defenses was to the effect that Smiley’s complaint failed to state facts sufficient to constitute a cause of action against Citibank; Smiley’s pleading, which was based on California law bearing on the amount of late payment fees, was without support because that law was preempted as to Citibank through section 85 by operation of the supremacy clause.

Smiley then filed in federal district court a motion to remand the action to the superior court. Her ground was that diversity jurisdiction was lacking because, properly considered, the matter in controversy did not exceed \$50,000.

Citibank in turn filed in federal district court a motion requesting leave to amend its petition for removal. It sought to add as a ground that the action, as a result of preemption, arose “under the Constitution, treaties or laws of the United States” – so-called “federal question jurisdiction” – under subdivision (b) of section 1441 of title 28 of the United States Code.

In due course, the federal district court filed an order denying Citibank's motion requesting leave to amend its petition for removal and granting Smiley's motion to remand. (*Smiley v. Citibank (South Dakota), N.A.* (C.D.Cal. 1993) 863 F.Supp. 1156). It denied Citibank's motion as untimely, although it noted that, "[g]iven the strength of Citibank's preemption argument and the strong public interest in developing a uniform and consistent body of federal banking law, [it] understands Citibank's desire to adjudicate this dispute in federal court." (*Id.* at p. 1162). It granted Smiley's motion, accepting as meritorious her claim that diversity jurisdiction was lacking because, properly considered, the matter in controversy did not exceed \$50,000.

Citibank then filed in the superior court a common law motion for judgment on the pleadings. Its ground was to the effect that Smiley's complaint failed to state facts sufficient to constitute a cause of action against it as a result of preemption through section 85. Smiley filed opposition. By leave of the court, the United States filed a statement of interest on behalf of the Comptroller of the Currency as amicus curiae in support of Citibank's position.

The superior court caused entry of a minute order wherein it denied Citibank's motion.

Citibank proceeded to file a petition for writ of mandate in the Court of Appeal, Second Appellate District, seeking to compel the superior court to vacate its order denying its motion and to enter a new and different order granting its request.

After soliciting and receiving opposition from Smiley, the Court of Appeal caused issuance of an alternate writ of mandate, compelling the superior court either to vacate its earlier order denying Citibank's motion and to grant its request or to show cause why, among other things, it should not be required to do so by peremptory writ.

Complying with the Court of Appeal's alternative writ of mandate, the superior court caused entry of a minute order. In that order, it vacated its earlier order denying Citibank's motion and proceeded to grant its request.

Thereupon, Smiley filed a notice of appeal in the superior court. That same day, the Court of Appeal discharged the alternative writ of mandate and dismissed Citibank's petition as moot.

Subsequently, the superior court filed an order, with reasons stated, granting Citibank's motion, and in accordance therewith filed a judgment of dismissal.

On appeal, the Court of Appeal affirmed.<sup>1</sup> Agreeing with the superior court on preemption through section 85, a majority of two justices concluded that its order granting Citibank's motion should be sustained. Disagreeing, a single dissenting justice would have held to

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<sup>1</sup> The Court of Appeal impliedly treated Smiley's appeal as taken from the superior court's judgment - which was appealable (see *Campbell v. Jewish Com. for P. Service* (1954) 125 Cal.App.2d 771, 773 (per Peters, P.J.)) - and not from its order granting Citibank's motion - which was not (*ibid.*).

the contrary. The majority relied in large part on *Greenwood Trust Co. v. Com. of Mass.* (1st Cir. 1992) 971 F.2d 818 (hereafter sometimes *Greenwood Trust*), which construes section 85 in the course of construing a provision evidently modeled on its language, viz., section 521 of the Depository Institutions and Monetary Control Act of 1980 (hereafter DIDA), codified in subsection (a) of section 1831d of title 12 of the United States Code, which covers federally-insured state banks and federally-insured branches of foreign banks. They also relied on the position taken by the Comptroller of the Currency. For his part, the dissenter criticized the *Greenwood Trust* court's reasoning and the Comptroller of the Currency's views, the former at length and in detail and the latter less so.

On Smiley's petition, we granted review. We now affirm.

## II

Smiley's sole contention is that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings.<sup>2</sup>

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<sup>2</sup> Citibank requests us to take judicial notice of matter reflected in several items, comprising the following: certain decisions of federal, sister-state, and English courts; certain documents from the Office of the Comptroller of the Currency and other federal administrative agencies; certain submissions filed in the courts of California and a sister state by the United States on behalf of the Comptroller of the Currency; and certain documents from Citibank relating to the terms of its "Preferred" credit card accounts in the general period pertinent here. We do

## A

In ruling on a common law motion for judgment on the pleadings made by a defendant, a trial court determines

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so. We are either required or permitted to take judicial notice (Evid. Code, § 459, subd. (a)) with respect to all such matter. Specifically, we are required to take judicial notice of decisions constituting the law of the United States. (*Id.*, § 451, subd. (a).) We are permitted to take judicial notice of the following: decisions constituting the law of any state of the United States (*id.*, § 452, subd. (a)); the law of any foreign nation (*id.*, § 452, subd. (f)); official acts of the executive departments of the United States (*id.*, § 452, subd. (c)); records of any court of record of any state of the United States (*id.*, § 452, subd. (d)); and "[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy" (*id.*, § 452, subd. (h)). Smiley argues against judicial notice of some of the matter in-question, but does so unpersuasively.

In conjunction with a brief filed as amicus curiae supporting Citibank's position, Chase Manhattan Bank, N.A., requests us to take judicial notice of matter reflected in several items, comprising certain decisions of sister-state courts and certain documents from federal administrative agencies. We do so. As stated above, we are permitted to take judicial notice with respect to all such matter.

Smiley effectively moves us to strike a brief filed by the Comptroller of the Currency as amicus curiae supporting Citibank's position. She argues that, by appearing under his own name, the Comptroller has acted outside his authority under the laws of the United States. He has not. (12 U.S.C. § 93(d) [*sic*: the subsection should be designated "(e)"].) Accordingly, we deny her request.

We note in passing that, during the course of this action, section 438 was added to the Code of Civil Procedure dealing with motions for judgment on the pleadings, and section 4001 was added to the Financial Code dealing with late payment fees in consumer credit agreements. Neither Smiley nor Citibank has

what has been called a pure question of law (*Donohue v. State of California* (1986) 178 Cal.App.3d 795, 802; *Goodley v. Wank & Wank, Inc.* (1976) 62 Cal.App.3d 389, 392-393), but what is in fact a mixed question of law and fact that is predominantly legal: Does the plaintiff's complaint state facts sufficient to constitute a cause of action against the defendant? (*Donohue v. State of California*, *supra*, 178 Cal.App.3d at p. 802; *Goodley v. Wank & Wank, Inc.*, *supra*, 62 Cal.App.3d at pp. 392-393.) In so doing, the trial court generally confines itself to the complaint and accepts as true all material facts alleged therein. (E.g., *Colberg, Inc. v. State of California ex rel. Dept. Pub. Wks.* (1967) 67 Cal.2d 408, 412.) As appropriate, however, it may extend its consideration to matters that are subject to judicial notice. (E.g., *ibid.*) In this, it performs essentially the same task that it would undertake in ruling on a general demurrer. That is not surprising. A common law motion for judgment on the pleadings "ha[s] the purpose and effect of a general demurrer." (*Kortmeyer v. California Ins. Guarantee Assn.* (1992) 9 Cal.App.4th 1285, 1293; see *Colberg, Inc. v. State of California ex rel. Dept. Pub. Wks.*, *supra*, 67 Cal.2d at pp. 411-412.)

An appellate court independently reviews a trial court's order on such a motion. (See *Lumbermens Mut. Cas. Co. v. Vaughan* (1988) 199 Cal.App.3d 171, 178-179;

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raised any claim that either provision is pertinent to the conduct of the proceedings or to the outcome thereof.

We also note in passing that Smiley asserts that the superior court's order, with reasons stated, granting Citibank's common law motion for judgment on the pleadings is "not reflective of the actual proceedings or pleadings in the case." So far as appears, it is.

*Crain v. Electronic Memories & Magnetics Corp.* (1975) 50 Cal.App.3d 509, 512; cf. 1 Childress & Davis, Federal Standards of Review (2d ed. 1992) § 5.01, p. 5-6 [stating that a federal district court's order on the analogous motion for judgment on the pleadings under rule 12(c) of the Federal Rules of Civil Procedure is subject to "review . . . de novo"].) That is certainly proper. Independent review is called for when the underlying determination involves a purely legal question or a predominantly legal mixed question. (E.g., *Crocker National Bank v. City and County of San Francisco* (1989) 49 Cal.3d 881, 888.) As stated, the determination here is such.

Finally, we as the court of last resort independently review a decision by a lower appellate court concerning a trial court's order on a motion of this sort. Indeed, we so review *all* such decisions. We have no need to defer, because we can ourselves conduct the same analysis. In fact, we have need *not* to defer, in order to be free to further the uniform articulation and application of the law within our jurisdiction.

## B

The question that is central to our analysis involves section 85 – which, as stated above, provides that a national bank "may take, receive, reserve, and charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located" – and the preemption of California law. It is clear that national banks are authorized to conduct credit card programs, to issue credit cards to holders, and to provide money thereunder to such persons and to others on their behalf in exchange for

goods or services. (12 C.F.R. § 7.7378 (1995); see 12 U.S.C. § 24 (Seventh) [authorizing national banks to "loan[] money on personal security"].) it is also clear that, in thus providing money under credit cards, a national bank makes "loans" within the meaning of section 85.

As to preemption generally, the law is as follows:

The supremacy clause declares, in pertinent part, that "Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." (U.S. Const., art. VI, cl. 2.)

Since the decision in *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316, 427, "it has been settled that state law that conflicts with federal law is 'without effect.'" (*Cipollone v. Liggett Group, Inc.* (1992) \_\_\_ U.S. \_\_\_ [112 S.Ct. 2608, 2617].)

Whether federal law preempts state law "fundamentally is a question of congressional intent. . . ." (*English v. General Electric Co.* (1990) 496 U.S. 72, 79; accord, *Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112 S.Ct. at p. 2617]; *Mangini v. R.J. Reynolds Tobacco Co.* (1994) 7 Cal.4th 1057, 1066; see, e.g., *N.Y. Conference of Blue Cross v. Travelers Ins.* (1995) \_\_\_ U.S. \_\_\_ [115 S.Ct. 1671, 1676-1677].)

Such preemption is found in "three circumstances." (*English v. General Electric Co.*, *supra*, 496 U.S. at p. 78.) "First, Congress can define explicitly the extent to which its enactments pre-empt state law." (*Ibid.*; accord, *Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112

S.Ct. at p. 2617].) "Second, in the absence of explicit statutory language, state law is pre-empted where it regulates conduct in a field that Congress intended the Federal Government to occupy exclusively." (*English v. General Electric Co.*, *supra*, 496 U.S. at p. 79; accord, *Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112 S.Ct. at p. 2617].) "Finally, state law is pre-empted to the extent that it actually conflicts with federal law." (*English v. General Electric Co.*, *supra*, 496 U.S. at p. 79; accord, *Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112 S.Ct. at p. 2617].)<sup>3</sup>

"Consideration of issues arising under the Supremacy Clause 'start[s] with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless that [is] the clear and manifest purpose of Congress.'" (*Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112 S.Ct. at p. 2617].) That appears to be true of preemption generally. (See *ibid.*) It is certainly true of "field preemption" specifically. (*English v. General Electric Co.*, *supra*, 496 U.S. at p. 79.) The "historic police powers of the States" extend to consumer protection. (E.g., *California v. ARC America Corp.* (1989) 490 U.S. 93, 101.) They extend as well to banking.

<sup>3</sup> The "three categories" of preemption referred to in the text should not be taken to be "rigidly distinct. Indeed, field pre-emption may be understood as a species of conflict pre-emption: A state law that falls within a pre-empted field conflicts with Congress' intent (either express or plainly implied) to exclude state regulation." (*English v. General Electric Co.*, *supra*, 496 U.S. at pp. 79-80, fn. 5; accord, *Gade v. National Solid wastes Management Ass'n* (1992) \_\_\_ U.S. \_\_\_ fn. 2 [112 S.Ct. 2374, 2386, fn. 2].)

(See *National State Bank, Elizabeth, N.J. v. Long* (3d Cir. 1980) 630 F.2d 981, 985-986; cf. *Lewis v. BT Investment Managers, Inc.* (1980) 447 U.S. 27, 38 [under the commerce clause: "both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern"].) It must be recognized, however, that federal authority has also affected banking since before enactment of the National Bank Act in 1864. (*National State Bank, Elizabeth, N.J. v. Long*, *supra*, 630 F.2d at p. 985.)<sup>4</sup>

Turning to the case at bar, we must be precise concerning the question of preemption.

The issue is not the *existence* of preemption under section 85. In *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299 (hereafter sometimes *Marquette*), which happens to have concerned credit card programs at national banks, the United States Supreme Court held that section 85 does in fact preempt state law within its coverage, apparently under the rubric of "conflict preemption." Looking to section 30 of the National Bank Act, the source of section 85, the *Marquette* court held that the latter authorizes a national bank to demand and collect interest on any loan, even an interstate loan, at the rate

<sup>4</sup> In his dissenting opinion, Justice Arabian takes the position that the standard for preemption applicable here "requires the invalidation of a state law *only* where it 'incapacitates the [national] banks from discharging their duties to the government. . . .'" (Dis. opn. of Arabian, J., *post*, at p. \_\_\_\_ [typed dis. opn. of Arabian, J., at p. 16], italics in original.) That is not the case. For his test, he quotes *McClellan v. Chipman* (1896) 164 U.S. 347, 357. A century of law, however, has intervened. (See fn. 5, *post*.)

permitted under its home state's law – even an unlimited rate (*Hiatt v. San Francisco National Bank* (9th Cir. 1966) 361 F.2d 504, 506-507; see *Daggs v. Phoenix National Bank* (1900) 177 U.S. 549, 555-556 [dealing with section 30 of the National Bank Act]) – notwithstanding the law of any other state. (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at pp. 307-319.) In short, it concluded that the provision empowers such a bank to "export" its home state's interest rate. In reaching its result, it addressed an argument that the " 'exportation' of interest rates . . . will significantly impair the ability of States to enact effective usury laws. This impairment, however, has always been implicit in the structure of the National Bank Act, since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates. [Citation.] This impairment may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards. But the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court." (*Id.* at pp. 318-319, fn. omitted.) In so many words, the *Marquette* court read section 85 as a choice-of-law provision, fixing the law of the national bank's home state relative to interest rates as the rule governing all loans, even interstate loans, notwithstanding the law of any other state. Section 85 thereby entrusts the question of the lawfulness of a national bank's interest rates to its home state and to its home state alone.<sup>5</sup>

<sup>5</sup> We note in passing that, in its preemption analysis, *Marquette* says not a word about whether section 85 "incapacitates

The issue, to return to our theme, is not the *existence* of preemption under section 85, but rather its *scope*. Its resolution will depend on the meaning that the term "interest" bears within the provision.

We cannot find the meaning of the term "interest" in section 85 itself. The provision simply does not define the word. (E.g., *Ament v. PNC Nat. Bank* (W.D.Pa. 1994) 849 F.Supp. 1015, 1019; *Watson v. First Union Nat. Bank of South Carolina* (D.S.C. 1993) 837 F.Supp. 146, 150; *Goehl v. Mellon Bank (DE)* (E.D.Pa. 1993) 825 F.Supp. 1239, 1241; *Nelson v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 794 F.Supp. 312, 317.)

Let us then proceed to consider the source of section 85, which is section 30 of the National Bank Act.

What we now call the National Bank Act was passed by Congress in 1864, in the midst of the Civil War, under the title, "An Act to provide a National Currency, secured by a Pledge of United States Bonds, and to provide for the Circulation and Redemption thereof." (Act of June 3, 1864, ch. 106, 13 Stat. 99.) It substantially repealed (*id.*, ch. 106, § 62, 13 Stat. 118) and superseded (*Id.*, ch. 106, §§ 1-61, 63-64, 13 Stat. 99-118) a statute enacted in 1863, under the title, "An Act to provide a national Currency, secured by a Pledge of United States Stocks, and to provide for the Circulation and Redemption thereof" (Act of Feb. 25, 1863, ch. 58, 12 Stat. 665). Its title was altered in

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the [national] banks from discharging their duties to the government' " (*McClellan v. Chipman*, *supra*, 164 U.S. at p. 357, quoting *National Bank v. Commonwealth* (1869) 76 U.S. (9 Wall.) 353, 362) – as it plainly does not. *Marquette* thus precludes Justice Arabian's standard for preemption. (See fn. 4, *ante*.)

1874 to "the national-bank act." (Act of June 20, 1874, ch. 343, § 1, 18 Stat. 123.)

In *Marquette*, the United States Supreme Court declared that the purpose of the National Bank Act was "to facilitate . . . a 'national banking system[]' " (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 315) – "in part," as it had earlier stated in *Tiffany v. National Bank of Missouri* (1873) 85 U.S. (18 Wall.) 409, 413 (hereafter sometimes *Tiffany*), to "provid[e] a currency for the whole country, and in part to create a market for the loans of the General government." Within this system, "[n]ational banks are instrumentalities of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." (*Davis v. Elmira Savings Bank* (1896) 161 U.S. 275, 283; accord, *Farmers', etc. Nat. Bank v. Dearing* (1875) 91 U.S. (1 Otto) 29, 33-34.)

In *Tiffany*, the United States Supreme Court declared that the purpose of section 30 of the National Bank Act, as it later stated in *Marquette*, was to grant national banks " 'most favored lender' status" in their home states. (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 314, fn. 26.) In *Tiffany's* words, the provision "was intended to give [national banks] a firm footing in the different States where they might be located. It was expected they would come into competition with State banks" – and others – "and it was intended to give them at least equal advantages in such competition." (*Tiffany v. National Bank of Missouri*, *supra*, 85 U.S. (18 Wall.) at p. 412.) "Most favored lender" status "was considered indispensable to protect them against possible unfriendly State

legislation. Obviously, if State statutes should allow to their banks . . . a rate of interest greater than the ordinary rate allowed to natural persons, National banking associations could not compete with them, unless allowed the same. On the other hand, if such associations were restricted to the rates allowed by the statutes of the State to banks which might be authorized by the State laws, unfriendly legislation might make their existence in the State impossible. A rate of interest might be prescribed so low that banking could not be carried on, except at a certain loss. The only mode of guarding against such contingencies was that which, we think, Congress adopted. It was to allow to National associations the [highest] rate allowed by the State. . . . This construction accords with the purpose of Congress, and carries it out. It accords with the spirit of all the legislation of Congress. National banks have been National favorites. They were established for the purpose, in part, of providing a currency for the whole country, and in part to create a market for the loans of the General government. It could not have been intended, therefore, to expose them to the hazard of unfriendly legislation by the States, or to ruinous competition with State banks" – or others. (*Id.* at pp. 412-413.) "In harmony with this policy is the construction we think should be given to the thirtieth section of the act of Congress we have been considering. It gives advantages to National banks over their State competitors. It allows such banks to charge such interest as" what was later called the state's "most favored lender." (*Id.* at p. 413.) Thus, the purpose of section 30 of the National Bank Act was to grant national banks "most favored lender" status in their home states – to protect them from

possible unfriendly state legislation, whether such legislation was unfriendly in intent or effect. "The mechanism of referring to state law" – to take words written in a different context but nevertheless fitting here – "is simply one designed to implement that . . . intent and build into the federal statutes a self-executing provision to accommodate to changes in state regulation." (*First National Bank v. Dickinson* (1969) 396 U.S. 122, 133.)<sup>6</sup>

With this in mind, we can undertake to construe the term "interest" in section 30 of the National Bank Act.

Looking at the National Bank Act itself, we find no express definition of the term "interest" in section 30. The provision itself does not offer a meaning. Neither does any other.

Surveying the National Bank Act within its context, we discover a basis for inferring an implied definition of the term "interest" in section 30.

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<sup>6</sup> In *Marquette*, the United States Supreme Court noted that the " 'most favored lender' status for national banks under *Tiffany* has since been incorporated into the regulations of the Comptroller of the Currency." (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 314, fn. 26.) See subsection (a) of section 7.7310 of title 12 of the Code of Federal Regulations (1995): "A national bank may charge interest at the maximum rate permitted by State law to any competing State-chartered or licensed lending institution. If State law permits a higher interest rate on a specified class of loans, a national bank making such loans at such higher rate is subject only to the provisions of State law relating to such class of loans that are material to the determination of the interest rate. For example, a national bank may lawfully charge the highest rate permitted to be charged by a State-licensed small loan company or morris plan bank, without being so licensed."

Around the time of the passage of the National Bank Act, according to one definition then current in American legal usage, "interest" was a "sum of money paid or allowed by way of compensation for the loan or use of another sum. . . ." (2 Burrill, A New Law Dictionary and Glossary (1851) p. 629, col. 1.) According to another such definition, "interest" was the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use." (1 Bouvier, A Law Dictionary (10th ed. 1860) p. 652, col. 1.) As subsequently restated by the United States Supreme Court: "Interest is the compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention. . . ." (*Brown v. Hiatts* (1872) 82 U.S. (15 Wall.) 177, 185.) This was the word's "plain meaning" (dis. opn. of Arabian, J., *post*, at p. \_\_\_ [typed dis. opn. of Arabian, J., at p. 6]) and "ordinary and commonly understood sense" (dis. opn. of George, J., *post*, at p. \_\_\_ [typed dis. opn. of George, J., at p. 3]).<sup>7</sup>

<sup>7</sup> In English legal usage, from which the American derived, the term "interest" carried substantially the same broad meaning as indicated in the text. Thus, in *Arnott v. Redfern* (1826 C.P.) 130 Eng.Rep. 549, 551-552, the court declared: "[I]t appears there are two principles on which interest is given in our courts: first, where the intent of the parties that interest should be paid, is to be collected from the terms or nature of the contract; secondly, where the debt has been wrongfully detained from the creditor."

Compare 7 Oxford English Dictionary (2d ed. 1989) pages 1099 to 1100: In medieval Latin, "*interesse* (Interest) differed from *usura* (Usury) in that the latter was avowedly a charge for the use of money, which was forbidden by the Canon Law; whereas originally '*interesse* refers to the compensation which under the Roman Law, was due by the debtor who had made

Thus, the term "interest" readily embraced a periodic charge based on a percentage of a certain sum, either the amount lent or some other, payable absolutely by maturity.

But the word was not so limited. As reported decisions demonstrate, it could include as well a late payment fee, payable contingently in the event of default after maturity. Such a fee could be calculated as a periodic percentage charge. (See *Wilkinson v. Daniels* (Iowa 1848) 1 Greene 179, 188; see generally Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious (1933) 82 A.L.R. 1213, 1214-1223 [collecting pre- and post-National Bank Act decisions].) It could also be fixed as a flat fee. (See *Craig v. Pleiss* (1856) 26 Pa. 271, 271-272, 272-274; *Wernwag et al. v. Mothershead et al.* (Ind.

default. The measure of compensation was *id quod interest*, the difference between the creditor's position in consequence of the debtor's laches and the position which might reasonably have been anticipated as the direct consequence of the debtor's fulfillment of his obligation'.") (Accord, *Library of Congress v. Shaw* (1986) 478 U.S. 310, 315, fn. 2 ["The institution of interest originated under Roman law as a penalty due from a debtor who delayed or defaulted in repayment of a loan. [Citation.] The measure of the penalty due for the default or delay was *id quod interest* - that which is between - the difference between the creditor's current position and what it would have been if the loan had been timely and fully repaid."].)

In his dissenting opinion, Justice George ignores the broad meaning of the term "interest" in American legal usage around the time of the passage of the National Bank Act. This is not surprising in view of the fact that, with the singular exception of *Greenwood Trust*, he fails to cite any of the scores of decisions and other authorities bearing directly on the question before the court.

1834) 3 Blackford 401, 401-402; see generally Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. at pp. 1214-1223 [collecting pre- and post-National Bank Act decisions].)<sup>8</sup>

<sup>8</sup> Even if used in conjunction with "rate," the term "interest" – contrary to what Justice Arabian implies in his dissenting opinion – was not limited to a periodic percentage charge, whether or not payable absolutely by maturity. (See *Wernwag et al. v. Mothershead et al.*, *supra*, 3 Blackford at pp. 401-402.) Thus, it was stated that a "promissory note . . . , on default of payment when due, drew interest at the rate specified in the note from the time it became due," to wit, " 'five dollars interest per week until paid.' " (*Ibid.*)

In his dissenting opinion, Justice George effectively asserts that the term "interest" could not include a late payment fee or indeed any other contingent charge. That is not so. *Lloyd v. Scott* (1830) 29 U.S. (4 Pet.) 205, on which he relies, does *not* define "interest" to exclude a late payment fee. It merely states that such a fee, "exceeding the lawful interest, . . . is not usury," i.e., *unlawful* interest, if avoidable by timely payment. (*Id.* at p. 226, *italics added.*) Similarly, *Spain v. Hamilton's Administrator* (1863) 68 U.S. (1 Wall.) 604, on which he also relies, does *not* define "interest" to exclude a contingent charge. It merely states that such a charge "of itself would be deemed insufficient to make a loan usurious," i.e., bearing *unlawful* interest. (*Id.* at p. 626.) Finally, Annotation, Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. 1213, on which he relies as well, all but expressly defines "interest" to include a late payment fee. As it declares in its title, the annotation deals with "interest after maturity." (*Id.* at p. 1213.) By tautology, "interest after maturity" is interest; by convention, "interest after maturity" is a late payment fee. Furthermore, the annotation states, as the "general rule," that "a provision in a note or other contract for the payment of money, by which the debtor agrees to pay after maturity interest at a higher rate than permitted by the usury laws, or a sum of money which will exceed that rate, does not render the note or other contract usurious, if the parties in making the contract act in good faith,

In view of the foregoing, we believe that the term "interest" in section 30 of the National Bank Act should be construed to cover late payment fees, if such fees are allowed by a national bank's home state. Recall the definition of "interest" as a "sum of money paid or allowed by way of compensation for the loan or use of another sum" (2 Burrill, A New Law Dictionary and Glossary, *supra*, p. 629, col. 1) or the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use" (1 Bouvier, A Law Dictionary, *supra*, p. 652, col. 1). Such language easily encompasses late payment fees, as compensation for use of money, specifically, its retention, beyond the loan's term. Also recall the cited case law. It confirms the conclusion. Lastly, recall the statutory context. If "interest" were not read as indicated above, the purpose of facilitating a national

without intent of evading the usury law." (*Id.* at p. 1214.) That means that a late payment fee is indeed *interest* – and is generally *lawful* interest. In view of the foregoing, we are able to see through the assertion that a late payment fee "would *not* be considered interest for the purpose of determining whether the loan exceeded the legally permitted rate of interest." (Dis. opn. of George, J., *post*, at p. \_\_\_\_ [typed dis. opn. of George, J., at p. 5], *italics in original.*) The quoted language is an attempt, ultimately unsuccessful, to veil over the fact that such a fee was generally considered lawful interest.

In his dissenting opinion, Justice Arabian effectively asserts that the term "interest" did not include a late payment fee. In doing so, he merely begs the question, simply and repeatedly labeling such a fee a "*non-interest-rate . . . term* [ ]." (Dis. opn. of Arabian, J., *post*, at p. \_\_\_\_ [typed dis. opn. of Arabian, J., at p. 1], *italics in original*; accord, *id.* at pp. \_\_\_\_ & \_\_\_\_ [typed dis. opn. of Arabian, J., at pp. 3, 7, 12, 13, & 15].) We need not respond.

banking system by granting national banks "most favored lender" status in their home states could be frustrated by unfriendly state legislation. Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks*, but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks*, at a level high enough that *they* could lend at a profit. Such a result would be untenable.<sup>9</sup>

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<sup>9</sup> In their separate dissenting opinions, Justice Arabian and Justice George suggest that Congress had no need to protect national banks through the "most favored lender" doctrine under section 30 of the National Bank Act insofar as late payment fees were concerned. To quote Justice George: "It has been quite well settled, since the early 1800's, that - even in the absence of a specific federal statutory prohibition - a state may *not* discriminate against a 'federal instrumentality' either in the enactment or the enforcement of state laws, and a national bank, of course, is a federal instrumentality." (Dis. opn. of George, J., *post*, at p. \_\_\_\_ [typed dis. opn. of George, J., at p. 7], italics in original; accord, dis. opn. of Arabian, J., *post*, pp. \_\_\_\_-\_\_\_\_ [typed dis. opn. of Arabian, J., at pp. 11-12].) By the same reasoning, Congress had no need to protect national banks at all. In *Tiffany*, however, the United States Supreme Court concluded that Congress had *in fact* provided them protection, whether it *needed* to do so or not. We are bound thereby.

In his dissenting opinion, Justice Arabian attempts to deconstruct the "most favored lender" doctrine, transforming it from a rule to protect national banks in their home states from possible unfriendly state legislation into a mechanism to prevent states from abolishing banking as an institution. He fails in his endeavor. He cannot overcome Senator Sherman, who, as the sponsor in the Senate of the bill that would become the National Bank Act, urged "most favored lender" status for national banks. (See Cong. Globe, 38th Cong., 1st Sess., p. 2126 (1864).) Neither can he overcome the *Tiffany* court, which articulated the doctrine as here presented not long afterwards. Lastly,

This is not to suggest that, in using the term "interest" in section 30 of the National Bank Act, Congress did not employ the word in the sense of a periodic percentage charge payable absolutely by maturity. It evidently did. (See, e.g., Cong. Globe, 38th Cong., 1st Sess., *supra*, pp. 1373-1376, 2123-2128.)

But it is to state that, in doing so, Congress did *not* employ the word *only* in that sense. Certainly, "rate" was not tied exclusively to that sense. (See fn. 8, *ante*; see also *Sherman v. Citibank (South Dakota)* (N.J. Super. Ct. App. Div. 1994) 272 N.J. Super. 435, 447, cert. granted (1994) 138 N.J. 270 [stating that "[w]hile interest rate . . . has been defined as the numerical percentage rate of interest, . . . the phrase need not be read so restrictively when construed in its statutory and historical context"].) By the time of the National Bank Act, banking had begun to change rapidly and radically. (See 2 Redlich, *The Molding of American Banking* (1951) pp. 85-98.) So too, governmental responses to such changes. (See *ibid.*) Aware that state legislation unfriendly to national banks had been enacted in the past (see, e.g., Madeleine, *Monetary and Banking Theories of Jacksonian Democracy* (1943) pp. 21-22; see also *McCulloch v. Maryland*, *supra*, 17 U.S. (4 Wheat.) at pp. 400-437), Congress was also aware that

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he cannot overcome the *Marquette* court, which reaffirmed the doctrine in the same form a century later. It may be noted in passing that the words of *Tiffany* on which he relies reflect a purpose not to prevent states from abolishing banking as an institution but, as explained in the text, to protect national banks in their home states from possible unfriendly state legislation, whether such legislation was unfriendly in intent or effect.

such legislation might be proposed in the future (see, e.g., Cong. Globe, 38th Cong., 1st Sess., *supra*, p. 1376). It was evidently to forestall unfriendly state legislation that Senator Sherman urged "most favored lender" status for national banks. (See *id.* at p. 2126; see also fn. 9, *ante.*) Congress must have known that unfriendly state legislation could be predicated on measures other than differential provisions concerning periodic percentage charges payable absolutely by maturity. Without question, it did not purport to limit protection to such charges. A limitation of this sort might not have been inappropriate in an ephemeral measure. But it would have appeared out of place in the National Bank Act. In the words of Representative Hooper, who "reported the bill that was to become the National Bank Act . . . to the House from the Ways and Means Committee" (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 315, fn. 28), the act was "not for a day" (Cong. Globe, 38th Cong., 1st Sess., *supra*, p. 1377). Quite the contrary. It was to perdure through the system of national banks that it established. Had Congress intended to limit protection, it would doubtless have made itself plain. It did not. Its silence is especially deafening when we consider that the immediate object of the National Bank Act was not the testing of an hypothesis concerning monetary theory, but rather the saving of the Union itself. (See *id.* at pp. 2128-2130.)<sup>10</sup>

<sup>10</sup> In their separate dissenting opinions, Justice Arabian and Justice George assert - to quote only Justice George - that "[t]here is absolutely nothing in" section 30 of the National Bank Act "that suggests that Congress . . . intended the statutory reference to 'interest' to include" late payment fees. (Dis. opn. of George, J., *post*, at p. \_\_\_\_ [typed dis. opn. of George, J., at p. 4];

In the years since the enactment of section 30 of the National Bank Act, including its codification in section 85, we have discerned nothing to affect the coverage of the term "interest." Amendments there have been. But none has borne on the point with which we are concerned.

Consequently, we believe that the term "interest" in section 85 should be construed to cover late payment fees, if such fees are allowed by a national bank's home state.<sup>11</sup>

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accord, dis. opn. of Arabian, J., *post*, at pp. \_\_\_\_-\_\_\_\_ [typed dis. opn. of Arabian, J., at pp. 4-6].) Nothing except the word itself, whose broad meaning in American legal usage around the time of the passage of the National Bank Act was a "sum of money paid or allowed by way of compensation for the loan or use of another sum" (2 Burrill, A New Law Dictionary and Glossary, *supra*, p. 629, col. 1) or the "compensation which is paid by the borrower to the lender or by the debtor to the creditor for its use" (1 Bouvier, A Law Dictionary, *supra*, p. 652, col. 1). Justice Arabian's position is especially curious. He recognizes that the question of the word's meaning is "antiquarian." (Dis. opn. of Arabian, J., *post*, at p. \_\_\_\_ [typed dis. opn. of Arabian, J., at p. 4].) He fails - or refuses - to see that the answer, as revealed in the definitions quoted above, is "antiquarian" as well.

<sup>11</sup> In his dissenting opinion, Justice George takes the position that the term "interest" in section 85 does not include any contingent charge, including a late payment fee. He founders on *Marquette*. There, the United States Supreme Court treated as "interest" the apparently typical periodic percentage charges on credit card transactions *that are contingent on the borrower's failure to pay his balance in full.* (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 302.)

Our construction of the term "interest" in section 85 accords with the decisions of practically all other courts. (See, e.g., *Ament v. PNC Nat. Bank*, *supra*, 849 F.Supp. at pp. 1018-1021; *Tikkanen v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 801 F.Supp. 270, 274-280; *Nelson v. Citibank (South Dakota) N.A.*, *supra*, 794 F.Supp. at pp. 316-320; *Copeland v. MBNA America, N.A.* (Colo. Ct. App. 1994) 883 P.2d 564, 565-566, cert. granted (Colo. 1994) 883 P.2d 564; *Sherman v. Citibank (South Dakota)*, *supra*, 272 N.J.Super. at pp. 440-450; cf. *Greenwood Trust Co. v. Com. of Mass.*, *supra*, 971 F.2d at pp. 829-830 [dealing with section 521 of DIDA: impliedly construing "the term 'interest' [in section 85] to encompass a variety of lender-imposed fees and financial requirements which are independent of a numerical percentage rate," including, evidently, late payment fees on credit card accounts]; but cf. *Copeland v. MBNA America, N.A.* (D.Colo. 1993) 820 F.Supp. 537, 540-541 [criticizing reasoning set out in *Greenwood Trust*].)<sup>12</sup>

<sup>12</sup> We recognize that, in *Mazaika v. Bank One, Columbus, N.A.* (1994) \_\_\_ Pa.Super. \_\_\_ [653 A.2d 640, 643-647], the Pennsylvania Superior Court, sitting in bank, held that the term "interest" in section 85 must be construed to cover only periodic percentage charges payable absolutely by maturity. In *Gadon v. Chase Manhattan Bank, (USA)* (1995) \_\_\_ Pa.Super. \_\_\_ [653 A.2d 697, 699], and *In re Citibank* (1995) \_\_\_ Pa.Super. \_\_\_ [653 A.2d 39, 40], panels of the Pennsylvania Superior Court followed *Mazaika*. We cannot. *Mazaika* - which is essentially unique among reported decisions - is altogether unpersuasive. It asserts, in substance, that in enacting section 30 of the National Bank Act Congress did not "intend[ ] anything other than the ordinary and popular meaning of the word 'interest', which a person of average intelligence and experience would understand," apparently a periodic percentage charge payable absolutely by maturity. (*Mazaika v. Bank One, supra*, \_\_\_

Our construction is also in line with interpretations of the Comptroller of the Currency, who "is charged with the enforcement of the [federal] banking laws" (*Investment Co. Institute v. Camp* (1971) 401 U.S. 617, 627; accord, *NationsBank of N.C. v. Variable Annuity Life Ins.* (1995) \_\_\_ U.S. \_\_\_ [115 S.Ct. 810, 813]). (See, e.g., Office of the Comptroller of the Currency, Notice of Proposed Rulemaking (Mar. 3, 1995) 60 Fed.Reg. 11924, 11940 [proposing to add subsection (a) of section 7.4001 to title 12 of the Code of Federal Regulations, which would provide that "[t]he word 'interest' as used in 12 U.S.C. 85 includes . . . late fees"]; Office of the Comptroller of the Currency, Interpretative Letter by Julie L. Williams, Chief Counsel (Feb. 17, 1995) pp. 9-11; Office of the Comptroller of the Currency, Interpretative Letter by Robert B. Serino, Deputy Chief Counsel (Policy) (Aug. 11, 1988) pp. 5-8; Office of the Comptroller of the Currency, Interpretative Letter by L.A. Jennings, Deputy Comptroller of the Currency (Feb. 24, 1955) p. 1; cf. Fed. Deposit Insurance Corporation, Advisory Opn. by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47 (July 8, 1992) p. \_\_\_ [(1992-1993 Transfer Binder) Fed. Bank. L. Rep. (CCH) ¶ 81,534, p. 55,731] [opining that section 521 of DIDA gives a covered financial institution the "right to charge late fees . . . permitted by [its] home state which are either

Pa.Super. at p. \_\_\_ [653 A.2d at p. 647].) The analysis in the text proves this statement wrong. We note in passing that the Pennsylvania Supreme Court has granted a petition for allowance of appeal in *Mazaika*. (No. 31 E.D. Allocatur Dock., May 25, 1995.) It has done the same in *In re Citibank*. (No. 80 E.D. Allocatur Dock., May 31, 1995.)

a component of interest or material to the determination of the interest rate"].)<sup>13</sup>

Lastly, our construction conforms with views of commentators. (See, e.g., Clark & Clark, *The Law of Bank Deposits, Collections and Credit Cards* (rev. ed. 1995) ¶ 15.09[2][c], pp. 15-56 – 15-61 & especially pp. 15-59 – 15-60; Rosenblum, *Exporting Annual Fees* (1986) 41 Bus. Law. 1039, 1042-1044.)

Against our conclusion, Smiley argues that the term "interest" in section 85 may not, or at least should not, be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. She asserts that the word should instead be interpreted as such compensation as is *either* "based on the amount of the loan balance" *or* "measured over time" *or* "required up-front as consideration for the loan."

Smiley's argument in favor of her own construction of the term "interest" in section 85 is unpersuasive. On its

<sup>13</sup> We recognize that, in a letter dated June 25, 1964, the then Comptroller of the Currency stated to a correspondent: "[Y]ou inquired as to what charges paid by consumers for consumer credit obtained from a National Bank with respect to auto financing are not considered to be interest. Charges for late payments . . . are illustrations of charges which are made by some banks which would not properly be characterized as interest." The letter was perfunctory. It did not even mention section 85. We agree with the present Comptroller of the Currency: "It is not clear that the quoted passage was issued in the context of a determination of whether the term 'interest' used in Section 85 includes late charges nor does the context of the letter clearly indicate that it is intended as a ruling of the agency with respect to that question."

very face, her interpretation is peculiar. It is not supported by either reason or authority. Hence, it cannot be accepted. Certainly, it might produce untoward consequences. Specifically, it might effectively limit the variety of credit terms permitted on an interstate loan by a national bank, because any such term beyond its scope would be subject to the varying laws of the several states – a result that might "throw into confusion the complex system of modern interstate banking" (*Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 312) and thereby undermine the conditions for uniformity and efficiency that would otherwise obtain. To limit the variety of credit terms would obviously have an adverse effect on the national bank itself, whose freedom to lend on conditions it deems reasonable would be restricted. But it would have a corresponding adverse effect on the national bank's potential customer, whose freedom to borrow on conditions *he* deems reasonable would also be restricted. To the extent that Smiley suggests that it is no longer necessary "to protect [national banks] against possible unfriendly State legislation" (*Tiffany v. National Bank of Missouri*, *supra*, 85 U.S. (18 Wall.) at p. 412), she is wrong. States have continued to enact measures that are unfriendly in effect if not in intent. (See, e.g., *Fisher v. First Nat. Bank of Omaha* (8th Cir. 1977) 548 F.2d 255, 258-261; *Northway Lanes v. Hackley Union Nat. Bank & Trust Co.* (6th Cir. 1972) 464 F.2d 855, 861-864; *United Missouri Bank of Kansas City v. Danforth* (W.D.Mo. 1975) 394 F.Supp. 774, 779-785; *Saul v. Midlantic Nat. Bank/South* (N.J. Super. Ct. App. Div. 1990) 240 N.J. Super. 62, 80-82.)

Smiley's argument against our construction of the term "interest" in section 85 is as unpersuasive as her argument in favor of her own.

In part, Smiley asserts that the term "interest" in section 85 may not be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. To do so, she claims, would compel a conclusion that Congress failed to define the word itself, but rather delegated the task to the several states in violation of section 1 of article I of the United States Constitution, which "vests" in it "[a]ll legislative Powers [t]herein granted." That is simply not the case. Congress has made no such delegation. As shown above, it has itself defined the word, impliedly if not expressly, to cover late payment fees, if such fees are allowed by a national bank's home state. True, it has adopted in this regard, as by a choice-of-law provision, the usury law of the national bank's home state as the rule governing all loans by the bank in question, even interstate loans, notwithstanding the law of any other state. It has thereby entrusted the question of the lawfulness of a national bank's late payment fees to its home state and to its home state alone. But it has not thereby made a delegation. In *United States v. Sharpnack* (1958) 355 U.S. 286, 294, the United States Supreme Court concluded that Congress did not delegate its legislative powers to the several states in the Assimilative Crimes Act of 1948, in which it adopted for each federal enclave the criminal law of the state in which such enclave is situated. Here, we conclude that Congress did not delegate its legislative powers to the several states in section 85, in which it adopted for each national bank the usury law of the state in which such bank is

located. (Accord, *Tikkanen v. Citibank (South Dakota) N.A.*, *supra*, 801 F.Supp. at p. 280; *Sherman v. Citibank (South Dakota)*, *supra*, 272 N.J.Super. at p. 449.)

In other part, Smiley asserts that the term "interest" in section 85 at least should not be construed to cover late payment fees, even if such fees are allowed by a national bank's home state. She says that the word as used in other contexts is of narrower compass. What is dispositive, however, is the word *as used here*.

Some of the non-section 85 authorities on which Smiley relies do not, in fact, show the term "interest" employed in a limited sense. Thus it is with section 521 of DIDA. Its purpose is "to achieve a measure of parity and competitive equity between national banks and" federally-insured state banks and federally-insured branches of foreign banks "by permitting" the latter "to enjoy the same 'most favored lender' status that national banks enjoy." (*Hunter v. Greenwood Trust Co.* (N.J. Super. Ct. App. Div. 1994) 272 N.J.Super. 526, 533, cert. granted (1994) 138 N.J. 270; accord, *VanderWeyst v. First State Bank of Benson* (Minn. 1988) 425 N.W.2d 803, 805-807.) There is no suggestion that "interest" in section 521 of DIDA is more restricted than in section 85. But if there were, it would be based on a fact peculiar to the former, viz., that it was enacted, in part, as a response to a situation that was greatly concerned with "interest" in the sense of a periodic percentage charge payable absolutely by maturity: as a matter of national economic necessity, covered financial institutions could not prudently lend money unless they imposed charges that were relatively high (*Greenwood Trust Co. v. Com. of Mass.*, *supra*, 971 F.2d at p. 826); but as a matter of state law, they were required to impose

charges that were relatively low (*ibid.*).<sup>14</sup> It scarcely needs mention that the "legislative history of [section 521 of DIDA], enacted in 1980, does not bear on the legislative history of [section 30 of] the National Bank Act, enacted in 1864." (*Nelson v. Citibank (South Dakota) N.A.*, *supra*, 794 F.Supp. at pp. 319-320.) We surely do not discern in section 521 of DIDA any understanding on the part of Congress that section 85 uses "interest" narrowly. Neither can we detect any intent by that body to implicitly "amend" the latter provision through the former.

By contrast, other of the non-section 85 authorities on which Smiley relies do indeed show the term "interest" employed in a limited sense – but, by definition, not in section 85. Thus, in *U.S. v. Texas* (1993) \_\_\_ U.S. \_\_\_ [113 S.Ct. 1631, 1635-1636] – which does not even allude to section 85 – it is held that federal common law requires a party owing a contractual debt to the United States to pay "prejudgment interest," which evidently

<sup>14</sup> See also Senate Report No. 96-368, 1st Session, page 19 (1979), 1980 United States Code Congressional and Administrative News, at page 255 (dealing with section 501 of DIDA, codified in section 1735f-7a of title 12 of the United States Code, which concerns state law provisions limiting the amount or rate of interest, discount points, or finance or other charges with respect to mortgage loans: "In exempting mortgage loans from state usury limitations, the committee [on Banking, Housing, and Urban Affairs] intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers."); accord, subsection (c) of section 590.3 of title 12 of the Code of Federal Regulations (1995) (administratively implementing section 501 of DIDA by regulation).

does not include "processing fees" or "penalty charges." But "prejudgment interest" under this rule has nothing to do with "interest" in section 85. Similarly, in section 102 et seq. of the Truth in Lending Act (hereafter TILA), which has been codified in section 1601 et seq. of title 15 of the United States Code, and its implementing administrative regulation, Regulation Z, which has been codified in part 226 of title 12 of the Code of Federal Regulations (1995) – neither of which even cites section 85 – "finance charge" is defined to include "interest" (15 U.S.C. § 1605(a)(1); 12 C.F.R. § 226.4(b)(1) (1995)) but to exclude, for example, late payment fees (12 C.F.R. § 226.4(c)(2) (1995)). But "finance charge" under this provision and regulation has nothing to do with "interest" in section 85. Moreover, the purpose of TILA is substantially different from that of section 85, inasmuch as the former "provides for full disclosure of credit terms rather than regulation of the terms or conditions under which credit may be extended" (*Johnson v. McCrackin-Sturman Ford, Inc.* (3d Cir. 1975) 527 F.2d 257, 262), whereas the latter is concerned with the regulation of such terms and conditions insofar as they may be established by national banks.<sup>15</sup>

<sup>15</sup> Other of the non-section 85 authorities on which Smiley relies are no more helpful to her cause. See, e.g., *Lloyd v. Scott*, *supra*, 29 U.S. (4 Pet.) at page 226 (pre-National Bank Act decision: not defining "interest"; stating that "a specific sum, exceeding the lawful interest," in case of late payment is not usury but a permissible penalty if avoidable by timely payment); *Spain v. Hamilton's Administrator*, *supra*, 68 U.S. (1 Wall.) at pages 625-626 (pre-National Bank Act decision: to similar effect); *Insurance Company v. Piaggio* (1872) 83 U.S. (16 Wall.) 378, 386 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; stating that a party

In addition, Smiley specifically asserts that the term "interest" in section 85 necessarily excludes late payment fees (at least such as are calculated as flat fees) because they are "penalties." That is simply not the case. (See *Sherman v. Citibank (South Dakota)*, *supra*, 272 N.J. Super. at p. 447 [stating that "there is nothing in the dictionary definition of interest which necessarily excludes late fees from the scope of that term"]; cf. *Citizens; National Bank v. Donnell* (1904) 195 U.S. 369, 373-374 (per Holmes, J.) [implying that "interest" under section 30 of the National Bank Act may include overdraft charges].)

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"cannot recover special damages for the detention of money due to him beyond what the law allows as interest"); *United States v. Childs* (1924) 266 U.S. 304, 307 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; stating that a "penalty is a means of punishment; interest a means of compensation"); *Kothe v. R.C. Taylor Trust* (1930) 280 U.S. 224, 226 (not defining "interest," either generally or under section 85 specifically; distinguishing liquidated damages and penalties); *Merchants' Nat. Bank v. Sevier* (C.C.E.D. Ark. 1882) 14 F. 662, 665 (not defining "interest," either generally or specifically under section 30 of the National Bank Act; implying that parties may not "lawfully stipulate for the payment of an attorney's fee, in addition to the principle [*sic*] and interest of the debt, and the costs and fees allowed by law" (italics added)); *In re Tastyeast, Inc.* (3d Cir. 1942) 126 F.2d 879, 882 (not defining "interest," either generally or under section 85 specifically: similar to *Kothe*); *Smith Mach. Co., Inc. v. Jenkins* (10th Cir. 1981) 654 F.2d 693, 696 (not defining "interest," either generally or under section 85 specifically: similar to *Lloyd and Spain*).

In his dissenting opinion, Justice George relies on a number of the non-section 85 authorities that we have considered. (See dis. opn. of George, J., *post*, at pp. \_\_\_\_ fn. 1 [typed dis. opn. of George, J., at pp. 5-6, fn. 1].) To no avail. (See p. \_\_\_\_ fn. 14, & pp. \_\_\_\_ *ante* [typed opn. at p. 29, fn. 14, & pp. 30-20].)

To the extent that Smiley maintains that late payments fees are, or at least were, unlawful *per se* under the common law, she is wrong. (See Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious, *supra*, 82 A.L.R. at pp. 1214-1223; Annot., Provision for Interest After Maturity at a Rate in Excess of Legal Rate as Usurious or Otherwise Illegal (1969) 28 A.L.R.3d 449, 454-465.)

To the extent that Smiley maintains that late payments fees are unjustifiable as a matter of policy, she is also wrong. As a general matter at least, late payment has no social utility. Indeed, it causes various costs relating to default, including collection - costs that may be especially high when, as is typically the case in credit card transactions, the underlying loan is unsecured. Late payment fees may be employed to impose default costs on late payers, who are responsible for them, and to avoid shifting them to timely payers, who are not. Fairness is served thereby: late payment fees make late payers shoulder the burden they themselves have created. In addition, the efficient use of limited resources is furthered: late payment fees deter late payers from creating the burden in the first place. Without question as to their legitimacy, differential periodic percentage charges payable absolutely by maturity are used to impose default costs, albeit *prospectively* on *projected* late payers, with higher or lower charges depending on the borrower's creditworthiness. It can be argued that late payment fees may properly be used to achieve the same end *retrospectively* on *actual* late payers: it may be said to be more equitable to require a given sum in late payment fees after the term of the loan from a borrower who turns out to be late than to extract

the same – or perhaps a greater – sum through a higher periodic percentage charge payable absolutely by maturity throughout the loan's term from a borrower who proves himself to be timely.

Smiley may then be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive – or, in *Marquette's* word, "exportable" – against a sister state's law involving its "historic police powers" in consumer protection and banking, "unless that [is] the clear and manifest purpose of Congress." (*Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. at p. \_\_\_ [112 S.Ct. at p. 2617].) As *Marquette* effectively holds, such a purpose may indeed be discerned in section 85. To the extent that she asserts that federal law may not preempt state law of this sort other than expressly, she finds no support in reason or authority.

Smiley may next be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive against a sister state's law beyond periodic percentage charges payable absolutely by maturity, or, perhaps more broadly, beyond such charges as are *either* "based on the amount of the loan balance" or "measured over time" or "required up-front as consideration for the loan." We do not see any logical basis for such a limitation. (See *Tikkanen v. Citibank (South Dakota) N.A.*, *supra*, 801 F.Supp. at p. 277 [stating that "nothing in the language of section 85 supports a definition of interest that fluctuates according to whether the national bank seeks to apply the interest

to interstate or intrastate transactions"]; *Nelson v. Citibank (South Dakota) N.A.*, *supra*, 794 F.Supp. at p. 320 [stating that such a definition "is without statutory support" and is in fact "untenable"].) Neither do we see any practical ground therefor. Substance must prevail over form. Simply put, a borrower is equally affected by paying \$15 in periodic percentage charges payable absolutely by maturity or \$15 in late payment fees. (See *First National Bank in Mena v. Nowlin* (8th Cir. 1975) 509 F.2d 872, 878.)

Smiley may lastly be understood to argue that, even if the term "interest" in section 85 is construed to cover late payment fees, if such fees are allowed by a national bank's home state, it should not be deemed preemptive against a sister state's *common law*. She is unpersuasive. Her sole basis is section 521 of DIDA, which is inapplicable, or more accurately her peculiar interpretation of that provision, which is over-narrow (see *Hunter v. Greenwood Trust Co.*, *supra*, 272 N.J.Super. at pp. 537-540). Contrary to her underlying assertion as to the latter provision, *Cipollone v. Liggett Group, Inc.*, *supra*, \_\_\_ U.S. \_\_\_ [112 S.Ct. 2608], did *not* hold that "implied pre-emption cannot exist when Congress has chosen to include an express pre-emption clause in a statute." (*Freightliner Corp. v. Myrick* (1995) \_\_\_ U.S. \_\_\_ [115 S.Ct. 1483, 1487].)

In making her various arguments, Smiley criticizes the reasoning of the *Greenwood Trust* court and the views of the Comptroller of the Currency. Since we have not relied on either except to show that the conclusions that

we ourselves have arrived at are not novel, we need not respond to her complaints.<sup>16</sup>

We acknowledge that, to construe the term "interest" in section 85 to cover late payment fees, if such fees are allowed by a national bank's home state, would empower a national bank to "export" its home state's law of usury in that regard. We also acknowledge that such "exportation" of the usury law of a national bank's home state would prevent sister states from enforcing their own usury laws to that extent against the national bank in question by entrusting the question of the lawfulness of the national bank's late payment fees to its home state and to its home state alone. We cannot, and do not, ignore the immanent [sic] threat to efforts by sister states to provide such protection as they deem fit to consumers who reside therein. But – to follow *Marquette* – this displacement of the usury laws of sister states has always been implicit in the structure of the National Bank Act, since residents of one state have ever been free to visit another to receive credit subject to the latter's usury law, even when that law permits unlimited interest. This displacement may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards. The protection of the usury laws of sister states, however, is an issue of policy committed to Congress. Any plea to amend section 85 to

<sup>16</sup> *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, and *Beasley v. Wells Fargo Bank* (1991) 235 Cal.App.3d 1383, on which Smiley relies, are each inapposite. None even mentions section 85.

further that end must be addressed to that body and not to this.

## C

Applying the law as set out above, we must reject Smiley's contention that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings.

Confining ourselves to Smiley's complaint and accepting as true all material facts alleged therein, we believe that the pleading does not state facts sufficient to constitute a cause of action against Citibank.

Smiley's complaint is based on California law bearing on the amount of late payment fees. It is, however, without support because that law is preempted as to Citibank through section 85. Citibank is a national bank. Its home state is South Dakota. Because the term "interest" in section 85 covers late payment fees, if such fees are allowed by a national bank's home state, it embraces Citibank's late payment fees, which are permitted by South Dakota pursuant to section 54-3-1 of the South Dakota Codified Laws. Whether California law would prohibit such fees, at least under certain circumstances, is of no consequence. That law is displaced.<sup>17</sup>

<sup>17</sup> We note in passing that Citibank's late payment fees appear roughly comparable with those authorized by the subsequently added section 4001 of the Financial Code, which deals with late payment fees. (See fn. 2, *ante*.)

Against our conclusion, Smiley argues to the following effect: her complaint "alleges" as a "material fact" that Citibank's late payment fees for its credit card accounts are not late payment fees *within the meaning of South Dakota law*, but rather "penalties"; if this "material fact" is accepted as true, California law bearing on the amount of late payment fees is not preempted as to Citibank through section 85; and if California law is not preempted in this regard, the superior court's order granting Citibank's motion was erroneous and the Court of Appeal's conclusion upholding that order was erroneous as well.

We are not persuaded. Smiley's complaint simply does not "allege" as a "material fact" that Citibank's late payment fees for its credit card accounts are not late payment fees within the meaning of South Dakota law, but rather "penalties." Indeed, the pleading does not even allude to South Dakota law at all. With the premise of her argument gone, the conclusion falls of its own weight. In any event, we ourselves have considered the question independently, and conclude that the late payment fees in question are indeed late payment fees

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We also note in passing that Smiley's construction of the term "interest" in section 85 as such compensation for use of money under loan as is *either* "based on the amount of the loan balance" *or* "measured over time" *or* "required up-front as consideration for the loan" seems broad enough to embrace Citibank's late payment fees for its "Preferred" credit card accounts, at least in part, because those fees – as shown by matters of which we have taken judicial notice (see fn.2, *supra*) – appear, at least in part, to be set with regard to the account balance *and* to be determined over monthly periods.

within the meaning of South Dakota law, and not "penalties."<sup>18</sup>

### III

For the reasons stated above, we conclude that the judgment of the Court of Appeal must be affirmed.

It is so ordered.

MOSK, ACTING C.J.

WE CONCUR:

KENNARD, J.

BAXTER, J.

WERDEGAR, J.

ARDAIZ, J.\*

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<sup>18</sup> Smiley may be understood to contend that Court of Appeal erred in its conclusion upholding the superior court's order granting Citibank's common law motion for judgment on the pleadings *insofar as that order failed to grant her leave to amend her complaint*. The claim fails. True, leave to amend a complaint – like the present – that does not state facts sufficient to constitute a cause of action should generally be granted if there is a reasonable possibility that the defect can be cured. (See, e.g., *Carney v. Simmonds* (1957) 49 Cal.2d 84, 97.) No possibility of this sort appears here. Certainly, the defect cannot be cured by "alleging" as a "material fact" that Citibank's late payment fees are not late payment fees within the meaning of South Dakota law.

\* Hon. James A. Ardaiz, Presiding Justice, Court of Appeal, Fifth District, assigned by the Acting Chairperson of the Judicial Council.

## DISSENTING OPINION BY ARABIAN, J.

I dissent. The majority offers up a thoroughgoing revision of the history of American banking to justify a result that could not conceivably have been in the minds of the members of the Civil War Congress. It is, moreover, one that ignores not only an unambiguous statutory text and a consistent legislative history but what is perhaps the most prominent feature of American banking since the National Bank Act was passed in 1864 – the “dual banking system,” under which Congress has historically deferred to the interests of the states in the regulation of national banks as to all matters except those essential to their role as instrumentalities of the federal government.

The setting of *non-interest-rate* credit card terms – like the late payment penalties charged California credit card users by out-of-state national banks at issue in this case – is a matter appropriate for regulation by the California Legislature. It is not one to be determined by the legislatures of a handful of small or sparsely populated states that have deregulated consumer credit in an attempt to attract the interstate credit card operations of large national banks.<sup>1</sup>

<sup>1</sup> Examining the shifting terrain of modern American banking in 1981, Judge Douglas Ginsburg wrote that “We have already seen Citicorp relocating some of its retail operations in South Dakota, and the Chase Manhattan and Morgan banks undertaking similar moves to Delaware. . . . In return for jobs and taxes, these jurisdictions have traded local entry rights and powers, but in each case their real purpose is to serve as a base state for national retail banking: the national charter enables the banks to extend credit to residents of other states at their new ‘home’ state interest rate, and newly provided state laws make

It may be that a nationwide banking system, especially in the consumer financial services marketplace, is the inexorable future of American banking. We have not as a nation reached that point, however, and the decision to do so and the means by which a truly interstate system of banking is to be effected are matters for Congress to decide, not a few large national banks aided by the compliant legislatures of South Dakota and Delaware.<sup>2</sup>

## I

The majority begins with the proposition that the purpose of the National Bank Act of 1864 (12 U.S.C.) was to grant to the newly established national banks “most favored lender status” by permitting them to charge the

these interest rates unlimited.” (Ginsburg, *Interstate Banking* (1981) 9 Hofstra L. Rev. 1133, 1370, fns. omitted.)

<sup>2</sup> It is worth noting that the power of the South Dakota legislature to affect the interests of California credit card holders endorsed by the majority is not limited to the setting (or the removal) of ceilings on late payment penalties; it encompass [sic] as well the manipulation of the following credit card charges: annual fees, grace periods, conditions of default, changes in terms provisions, bad check charges, and restrictions on the imposition of attorneys’ fees and collection costs. (See Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator’s View of Interstate Credit Card Transactions* (1987) 42 Bus. Law. 929, 930.) As the majority point out, the Legislature enacted a measure effective January 1, 1995, adding division 1.1 to the Financial Code, dealing with the setting of fees in consumer credit transactions. (See maj. opn., ante, at p. \_\_\_, fn. 2 [typed maj. opn. at p. 6, fn. 2].) Notwithstanding this recent change, the federalist question remains not how the Legislature has decided to regulate consumer financial services, but the extent of its power to act as it sees fit.

highest *rate of interest* allowed to lenders (including non-bank lenders) by the state in which the national bank is located. That, I agree, is the holding of the high court in *Tiffany v. National Bank of Missouri* (1873) 85 U.S. (18 Wall.) 409 (*Tiffany*). From the platform of this almost commonplace perception, rooted in the language of the *Tiffany* opinion itself, the majority then vaults to the far more disputable conclusion that Congress must have had in mind, not only "interest" in its "popular sense" – a sum charged for the lending of money, calculated at a periodic percentage over time, that is, *rates of interest* – but non-interest-rate credit terms such as, in this case, "late payment fees, if such fees are allowed by a national bank's home state." (Maj. opn., *ante*, at p. \_\_\_\_ [typed maj. opn. at p. 19].)

This expansive definition of interest is required, according to the majority, not because of any evidence that Congress *actually* had such an idea in mind when it enacted the National Bank Act; in fact, there is not a particle of textual or legislative evidence to support such a view. Instead, the majority reasons that Congress must have intended to give "interest" such a broadened definition because limiting the word's meaning to the one that is obvious on the face of the statute would have allowed unfriendly state legislatures to "frustrate" the rise of the national banks by passing discriminatory measures imposing low *non-interest* terms (such as late fee penalties) on such banks while increasing the ceilings on such charges that state banks could impose. Such a course would have led to the destruction of the national banks, the majority reasons, an outcome Congress could not

have desired. To avoid such a result, the majority concludes, "the term 'interest' in section 30 of the National Bank Act should be construed to cover late payment fees. . . ." (Maj. opn., *ante*, at p. \_\_\_\_ [typed maj. opn. at p. 19].)

Like the proverbial red thread, a misconception not only of the high court's opinion in *Tiffany*, *supra*, 85 U.S. (18 Wall.) 409, but of the economic conditions prompting the enactment of the National Bank Act on which the *Tiffany* opinion rests, runs through the logic of the majority's view. A sharp pull on this skein of error – by demonstrating the misreading of *Tiffany* and of the larger historical context of American banking in the immediate aftermath of the Civil War – and the fabric of the opinion unravels.

## A

We begin with the text of the statute itself. In enacting what was originally section 30 of the National Bank Act in 1864, Congress used the word "interest" a total of four times. It used the word "rate," however, a total of *nine* times, more than twice as often as it used the word "interest." Indeed, "interest" *does not appear in a single sentence of section 30 unaccompanied by the word "rate"*; the statute commonly links directly the two ideas, referring to "rates of interest" or "interest at a rate of," although sometimes it refers to "rates" *without* referring to "interest" in the same sentence. Whatever broader currency the word "interest" may have had in American society at large in the mid-19th century, uncoupled from the notion of rates, it is highly likely that in enacting section 30,

Congress actually had in its collective mind a much narrower and more precise understanding, the one the majority calls the "popular sense" of the word: a sum linked to the lending of money calculated at a *rate* or a percentage of the loan over time.

Such a self-evident and unambiguous use of the term should mark the end of the inquiry, the question before this court being, after all, the antiquarian one of the content Congress probably ascribed to a word inserted in a statute in 1864. The answer, it is evident to me, is furnished by the text of the statute itself. Another court, examining the identical question, and rejecting the very construction placed on the text by the majority, has written that "a proposition that is not obvious from the plain meaning of a statute's language, nor from its legislative history, simply cannot be regarded as a clear manifestation of congressional intent." (*Copeland v. MBNA America, N.A.* (D.Colo. 1993) 820 F.Supp. 537, 541; see also *Mazaika v. Bank One, Columbus, N.A.* (Pa. Super. Ct. 1994) 653 A.2d 640, 647 (in bank) [" . . . we are simply unable to find that Congress, when it used the phrase 'interest at the rate' in enacting Section [30] . . . intended anything other than the ordinary and popular meaning of the word 'interest', which a person of average intelligence and experience would understand. (Fn. omitted.)"].)

During the Senate debate on the bill that became the National Bank Act, moreover, the talk was of interest "rates," not of abstract notions of interest encompassing the expansive formulation of the majority. Thus, in the midst of the debate over the bill's terms on May 5, 1864, the senators discussed the controversial proposal whether to enact into law a national interest rate ceiling of 7

percent. Senator Grimes of Iowa sought to have the ceiling reduced to 6 percent, the figure prevailing in his state. "This bill purports to be a bill to provide a national currency, and its friends claim that it is to have a uniform operation all through the country. Let me tell the Senate how it will operate in [Iowa]. In the State of Iowa the legal *rate of interest* is six per cent., but where special contracts are entered into the parties can receive ten *per cent.* Under this bill as it stands each of these national banks can receive ten *per cent.* on all its discounts and all its monetary transactions, while in the adjacent States the rate will be only six *per cent.*" (Cong. Globe, 38th Cong., 1st Sess. 2123 (1864).)

After further criticizing the measure, the senator concluded, "This is no time to be increasing the *rate of interest.*" Senator Pomeroy of Kansas disagreed: "I only desire to say that I think a uniform *rate of interest* is desirable and should be fixed in this bill, if it is to be a bill to establish a national currency. . . ." Senator Trumbull disagreed with both of his colleagues. "Money is worth more in some portions of the country than others. Money commands a higher *rate of interest* in new sections of the country than it does in the old. . . . This provision . . . allows the same *rate of interest* in a State which is allowed by the laws of the State." (Cong. Globe, 38th Cong., 1st Sess. 2123-2124 (1864), italics added throughout.)

Examples could be multiplied, but there would be little point. The fact is that there is literally nothing in the reported debates on the bill that became the National Bank Act of 1864 to suggest that the drafters of the measure had anything in mind beyond the common

sense, conventional notion of "rates of interest." The record of the congressional debates on the meaning of "interest" as Congress used it in the National Bank Act is thus further evidence – in addition to the unambiguous text of the statute itself – that Congress had in mind a notion of interest that was linked ineluctably to rates. (See Cong. Globe, 38th Cong., 1st Sess. 2123-2125, *supra*.)

### B

Indeed, the repeated and uniform linkage of "interest" with "rates of interest" in both statutory text and Senate debate is so clear and unwavering that even the majority quickly abandons any pretense of adhering to the plain meaning of the statute. Instead, it falls back on a kind of argument from necessity which it then projects onto an undisclosed consciousness of the Civil War Congress. The source of this line of argument is the high court's opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, mobilized by the majority as the pivot for an expansive reading of the word "interest" as it appears in section 30 of the National Bank Act.

Here is the argument deployed by the majority to support its central conclusion: "Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, *including national banks*, but fix them at a rate so low that they could lend only at a loss. It might then allow late payment fees to some lenders, *not including national banks*, at a level high enough that they could lend at a profit. Such a result would be untenable." (Maj. opn., *ante*, at p. \_\_\_\_ [typed n.a.j. opn. at pp. 19-20], italics in original.)

A fair reading of the opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, however demonstrates that the high court, writing a mere nine years after the passage of the National Bank Act, alluded not to Congress's fear of the specter of discriminatory rate setting against *national* banks by the states, but to its concern that state legislatures might abolish *all banks*, state and federal. Such an anxiety over the fate of the entire business of banking lends no support to the majority's claim that Congress must have been motivated to provide against the contingency of discriminatory rate setting by incorporating (with conspicuous silence) an understanding of "interest" that includes charges unrelated to what is the obvious subject of section 30 – that is, "rates of interest."

Here is the critical text of Justice Strong's opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, upon which the majority relies for its central tenet that Congress must have had in mind a notion of interest broad enough to encompass not just rates of interest, but non-interest-rate credit card terms including, in this case, late payment penalties, in order to avoid state discrimination against national banks: "It was expected that [national banks] would come into competition with State banks, and it was intended to give them at least equal advantages in such competition. In order to accomplish this they were empowered to reserve interest at the same rates . . . which were allowed to similar State institutions. This was considered indispensable to protect them against possible unfriendly State legislation. Obviously, if State statutes should allow [state] banks . . . a rate of interest greater than the ordinary rate allowed to natural persons, National [banks] could not compete with them, unless allowed the same. On the other hand, if such [national

banks] were restricted to the rates allowed . . . to [state] banks . . . , unfriendly legislation might make their existence in the state impossible. A rate of interest might be prescribed so low that *banking could not be carried on, except at a certain loss.*" (85 U.S. (18 Wall.) at pp. 412-413, italics added.)

I suppose it is possible to construe this text as referring to the threat of state discrimination against national banks by the setting of interest rate differentials that favored state banks. In point of historical fact, however, the greater likelihood is that Justice Strong had in mind what the words of his opinion literally convey: that the states might enact legislation that, far from favoring state banks over national banks, would sweep away *all banks*, leaving the business of lending (and the circulation of bank notes) to *non-bank* lenders. In other words, just as Justice Story wrote in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, 413, that "*banking* [not merely *national banking*] could not be carried on" in the face of across-the-board interest rate ceilings that would have made the business of banking itself a losing proposition. The radical policy of prohibiting banks had in fact been adopted in some of the states – Texas (1845), and Iowa and Arkansas (both in 1846), among them – in the not too distant past. (See Hackley, *Our Baffling Banking System* (1966) 52 Va. L. Rev. 565, 570 and fn. 20 (hereafter Hackley); Hammond, *Banks and Politics in America* (1957) p. 614.)

At this historical distance, it is easy to lose sight of the fact that in 1864 the history of American banking had been one of decades of financial turmoil, cyclical bank "panics," the sudden appearance and disappearance of "wildcat" banks, the absence of a national currency (and

of national banks), and volatile, often worthless notes issued by private state-chartered banks. The country's first "central bank," the Bank of the United States, had been destroyed in its second incarnation by President Jackson's veto of its charter renewal in 1832. The following period, roughly from 1836 to 1863, often referred to as the era of "free banking," was one of the most chaotic in American financial history, an era in which all banking was carried on by state chartered banks that issued their own currencies and in which the very idea of banks and bankers came to be distrusted by many Americans.<sup>3</sup> (Hackley, *supra*, 52 Va. L. Rev. at p. 570; Hammond, *Banks and Politics in America, supra*, at pp. 605-622, 725-26; Million, *The Debate on the National Bank Act of 1863, supra*, 2 J. of Political Economy 251, 261-266.)

The debased currencies of the state banks, together with the federal government's complete withdrawal from the field of financial regulation during the Jackson administration, contributed in the minds of many to the rebellion of the slave-holding states. With enormous

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<sup>3</sup> A vivid sense of what must have seemed the financial chaos surrounding the most everyday affairs of the average citizen can be gained from the observations of a writer in the January 1863 issue of *Merchants' Magazine* describing the currency of the West as including "the 'shinplasters' of Michigan, the 'wild-cats' of Georgia . . . the 'red-dogs' of Indiana and Nebraska, the miserably engraved 'rags' of North Carolina and Kentucky . . . and the not-soon-to-be-forgotten 'stumptail' of Illinois and Wisconsin. . . ." (Quoted in Million, *The Debate on the National Bank Act of 1863* (1894) 2 J. of Political Economy 251, 264, fn. 2.) In an era of ubiquitous Federal Reserve notes, it requires an act of imagination to realize that these characterizations were applied to what at the time passed for money.

sums suddenly and urgently required by the national government to pay its troops and finance the widening war, it is little wonder that Salmon Chase, Lincoln's Treasury Secretary, should call on Congress to enact legislation establishing a uniform national currency to be issued by federally chartered banks. Thus the immediate impetus for the National Bank Act.<sup>4</sup>

Against this backdrop, what Congress likely feared was not that the states would favor their local banks over those holding newly issued federal charters by setting discriminatory interest rates, but that the institution of private commercial banking itself would be abandoned in favor of other forms of lending in a country that, though still in its financial youth, had had much bitter experience

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<sup>4</sup> To Secretary Chase and others, one of the central objectives of the National Bank Act and allied legislation was the destruction of the state banking system and the assumption of federal control of the nation's banking, a condition that almost came to pass after Congress levied a 10 percent tax on state bank notes in 1865, prompting most of the state banks to convert to federal charters and marking the end of the era of state bank notes. Between 1864 and 1869, the number of state banks fell from a high of 1,089 to a low of 259, while national banks increased from 467 to 1,617. (See Anderson, *Federal and State Control of Banking* (1934) pp. 72-74; Redford, *Dual Banking: A Case Study in Federalism* (1966) 31 *Law & Contemp. Prob.* 749, 755.) State banks launched a come-back of sorts over the following decades, primarily because of the increasing importance of banks drafts in lieu of money, eventually achieving a rough equilibrium with their national competitors. It is this historically inadvertent coexistence of state and federally chartered banks in the aftermath of the National Bank Act that has come to be referred to as the "dual" banking system. (See, e.g., Hackley, *supra*, 52 *Va. L. Rev.* 565, 572.)

with a system that relied on largely unregulated state-chartered banks for its medium of exchange. It was thus to induce state banks to convert their charters and to protect the future of *banking* itself, that Congress tied national bank interest rate ceilings to those set by local legislatures for lenders *other than* state banks.<sup>5</sup>

That linkage, however, gives no support to the majority's argument that Congress must have intended to invest the term "interest" with a meaning that is broader than the text of the statute and legislative materials will support. Because Congress's aim in allowing national banks to adopt the highest rate of interest charged by non-bank lenders was not to head off local efforts to destroy national banks by setting discriminatory fees favoring state banks, there is no historical or legal basis for the conclusion that the term "interest" in section 30 . . . should be construed to cover late payment fees. . . . " (Maj. opn., *ante*, at p. — [typed maj. opn. at p. 19].)

### C

There is another thread prominent in the intellectual fabric of the immediate post-Civil War era that reinforces

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<sup>5</sup> As one comment has observed, at the time the *Tiffany* opinion was written, national banks outnumbered state banks by a ratio of seven to one, the latter being in a general state of collapse in the aftermath of the federal impost on their circulating notes. Faced with the impending "nationalization" of banking, "it is not inconceivable that states would enact retaliatory usury laws so that profitable loans could be made only by non-bank lenders." (Comment: *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View* (1982) *Vill. L. Rev.* 1077, 1085, fn. omitted.)

the view that in its opinion in *Tiffany, supra*, 85 U.S. (18 Wall.) 409, the high court had in mind, not discriminatory fee differentials directed at national banks, but the legislative abolition of banks themselves. That is the already well-rooted constitutional doctrine, perhaps then even more vivid in the minds of lawyers and judges than it is today, of federal instrumentalities and their correlative immunity from impairment by state laws. It was, after all, two cases involving the Bank of the United States that Chief Justice Marshall had chosen as the vehicles to establish the proposition that "the bank is an instrument which is 'necessary and proper for carrying into effect the powers vested in the government of the United States' " and was thus immune from state taxation. (*Osborn v. Bank of the United States* (1824) 22 U.S. (9 Wheat.) 738, 860; see also *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316, 436-437 ["... this is a tax on the operations of the bank, and is, consequently, a tax on the operation of an instrument employed by the government of the Union to carry its powers into execution. Such a tax must be unconstitutional."].)

It was only two years after *Tiffany, supra*, 85 U.S. (18 Wall.) 409, was decided that the court decided the *Dearing* case (*Farmers' and Mechanics' National Bank v. Dearing* (1875) 91 U.S. 29), reaffirming the view that the privately owned national banks were "instruments designed to be used to aid the government in the administration of an important branch of the public service." (*Id.* at p. 33.) There is thus no doubt whatever that not only Justice Strong and the high court of 1873, but the Congress of 1864, well knew that no state constitutionally could enact

measures, like differential rate ceilings, which discriminated against the national banks as fiscal instrumentalities of the national government. Given that widespread recognition in legislative and legal circles, there is simply no warrant for the inference by the majority that Congress must have used the word "interest" in a sense broader than the text will support in order to neutralize state efforts to favor state over federally chartered banks.

## II

The second line of argument anchoring the majority's broadened reading of the word "interest" in section 30 is derived from the comparatively recent decision in *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299 (*Marquette*) – the only high court opinion that speaks to the doctrine of "exportation" as a species of federal preemption. (See maj. opn., *ante*, at pp. \_\_\_\_-\_\_\_\_ [typed maj. opn. at pp. 11-12].) Although the majority avoids any express reference to the context in which the case before us arises and to the forces that drive both it and companion litigation across the nation – the recent emergence of truly "interstate" or nationwide banking in the area of consumer financial services – they rely heavily on the high court's reasoning in *Marquette* to support the conclusion that inequalities between late charge ceilings set by California and those allowed Citibank by the South Dakota legislature have "always been implicit in the structure of the National Bank Act." (Maj. opn., *ante*, at p. \_\_\_\_ [typed maj. opn. at p. 34].) They are "implicit," of course, only if one accepts the flawed reasoning of the majority that when Congress spoke of "interest rates" it

really meant something more than that, namely, *non-interest-rate* charges, including late payment penalties.

The vice of this reasoning is that neither the high court in *Marquette, supra*, 439 U.S. 299, nor the Congress of 1864 wrote or legislated against a backdrop of interstate banking, an arrangement that did not exist even in 1978 and was inconceivable in 1864. Instead, both the *Marquette* court and the Congress that debated and passed the National Bank Act acted against the backdrop of a geographically confined, *intrastate* system that has characterized American banking since the founding of the nation and only now appears to be in a state of rapid disintegration. (See, e.g., Miller, *Interstate Banking in the Court* (1985) Sup. C. Rev. 179; Huertas (1983 Benston edit.) *The Regulation of Financial Institutions: A Historical Perspective on Current Issues - The Changing Institutions and Government Policy* (1983) 1, 26-27; Ginsburg, *Interstate Banking, supra*, 9 Hofstra L. Rev. 1133; see also *Bank Regulators Set Interstate Guidelines*, N.Y. Times, May 9, 1995 (at p. C1, col 6) [state bank regulators disclose new guidelines putting into effect laws allowing interstate banking].)

The opinion in *Marquette, supra*, 439 U.S. 299, of course, addressed only the question of interest rates; it does not hint at, much less embrace, the Pickwickian notion of "interest" embraced by the majority. Moreover, the high court's statement in *Marquette* that in enacting the National Bank Act, Congress debated the measure "in the context of a developed interstate loan market" (*id.*, at p. 317), is of little value to the majority's reasoning. It simply does not follow from the premise of *Marquette* - that because the Congress of 1864 was aware of the

regional nature of the American economy, inequalities in interstate interest rates were implicit in section 30 - that Congress must have used the term "interest" in section 30 to include *non-interest-rate* credit terms such as late payment penalties.

Given the system of regional banking that even today continues to be the prevailing pattern, it is evident that in 1864 American banks did not "export" rates across state lines or that they even conceived of doing so. Congress thus could not have legislated with an awareness, however unarticulated, of "true" interstate banking as we are only coming to perceive it, however dimly, today. The pressures that drive the economic behavior of Citibank and like banks (and that lead to class actions such as this one) were unknown to the world of American banking until around 20 years ago. Because the Congress of the Civil War era could not have foreseen such developments, it could not have enacted section 30 of the National Bank Act with the idea of "interest" in mind that the majority attributes to it, that is, one that permits the exportation of credit terms - including late payment penalties - unrelated to interest rates allowed by the exporting bank's home state.

In short, the "exportation" of interest rates is a phenomenon associated with the contemporaneous rise of true interstate banking. There is certainly no hint of it in the *Tiffany* opinion, which deals solely with interest rates in the intrastate context. The word itself, in the context of banking, does not appear in the case law until around the time of the high court's opinion in *Marquette, supra*, 439 U.S. 299, in 1978. (See generally, Clark, *The Law of Bank Deposits* (3d ed. 1990) § 11.09[2], pp. 1145-1148.) The

result in *Marquette*, although based in part on the conclusion that the Civil War Congress was sensitive to the development of a system of regional banking (439 U.S. at p. 317), does not depend on the entirely retrospective idea that the Congress that enacted section 30 was in any sense aware of the future exfoliation of interstate banking a century and a quarter later, with its manifold pressures to nationalize credit card interest rates and consumer credit terms generally. (See generally, Ginsburg, *Interstate Banking*, *supra*, 9 Hofstra L. Rev. at p. 1135.)

It is clear, in short, that the majority reads back into the intent of the Civil War Congress an anachronistic awareness of the imperatives of modern interstate banking, an awareness that, because it did not exist at the time, could not have weighed on Congress's collective consciousness. It is equally clear from the historical materials that Congress was concerned with ensuring the survival of the newly established national banks in the context of a banking industry geographically confined within a single state and operating through single outlets. To thus suggest, as the majority does, that the power of South Dakota to dictate *non-interest-rate* terms to California credit card holders in violation of California law is "implicit" in the word "interest" as it was meant by the framers of the National Bank Act represents an account of the history of American banking that cannot be squared with the reality.

### III

Having relied on the foregoing materials and arguments – the clear and unambiguous text of the statute

itself, the tenor of the debate in the Senate, the high court's opinion in *Tiffany*, *supra*, 85 U.S. (18 Wall.) 409, the bitter national experience against which these events took place, and modern patterns in the nation's banking marketplace – it must be said that, in the end, the truth of none of these matters need be established in order to undermine the majority's conclusion. Because the principle of exportation is a branch of the doctrine of federal preemption, the governing test requires only a showing that the purpose ascribed to Congress by the majority is *less than* "clear and manifest." (*Cipollone v. Liggett Group, Inc.* (1992) 505 U.S. \_\_\_\_ [112 S.Ct. 2608, 2617]; *Mangini v. R.J. Reynolds Tobacco Co.* (1994) 7 Cal.4th 1057, 1066.)

So solicitous has Congress historically been of the interests of the states in the regulation of banking, both state and federally chartered, that the high court has adopted an especially restrictive standard of preemption by which to judge federal laws that impact state regulation of federal banks. That test, announced by the high court at least a century ago in such cases as *McClellan v. Chipman* (1896) 164 U.S. 347, requires the invalidation of a state law *only* where it "incapacitates the [national] banks from discharging their duties to the government. . . ." (*Id.* at p. 357; see also *Anderson National Bank v. Lockett* (1944) 321 U.S. 233, 248 [invalidation only where state laws "infringe the national banking laws or impose an undue burden on the performance of the banks' functions"]; *Lewis v. Fidelity Co.* (1934) 292 U.S. 559, 566 [subject to state law unless it "interferes with the purposes of its creation, or destroys its efficiency, or is in conflict with a paramount federal law"]; *First National Bank v. Kentucky* (1869) 76 U.S. (9 Wall.) 353, 362; *Davis v.*

*Elmira Sav. Bank* (1896) 161 U.S. 275, 283; see also Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation* (1979) 32 Stan. L. Rev. 687, 690-695.)

The preemption test specially applicable to state banking laws as they affect national banks, reflecting as it does a generous deference to state banking laws in the regulation of federally chartered banks, is consistent with the long history of the dual banking system, one feature of which is that "[n]ational banks 'are subject to the laws of the State and are governed in their daily course of business far more by the laws of the State than of the nation.' " (*McClellan v. Chipman*, *supra*, 164 U.S. at pp. 356-357, quoting *National Bank v. Commonwealth* (1869) 76 U.S. (9 Wall.) 353, 362.) As we said of the dual system in *Perdue v. Crocker Bank* (1985) 38 Cal.3d 913, " '[w]hatever may be the history of federal-state relations in other fields, regulation of banking has been one of dual control since the passage of the first National Bank Act in 1863. . . . In only a few instances has Congress explicitly preempted state regulation of national banks. More commonly, it has been left to the courts to delineate the proper boundaries of federal and state supervision [¶] The judicial test has been a tolerant one. [National banks'] right to contract, collect debts, and acquire and transfer property are all based on state law.' [Citation.] Thus the rule is that state laws apply. . . . " (*Id.* at p. 937, quoting *National State Bank, Elizabeth, N.J. v. Long* (3d Cir. 1980) 630 F.2d 981, 985.)

The California statute nominally at issue in this case – section 1671, subdivisions (c) and (d), of the Civil Code – can hardly be said to fail to pass constitutional muster under the governing test. Certainly on the basis of the

text of section 30 alone, Congress's intent to displace credit terms other than interest rates applicable to out-of-state national banks is far less than "clear and manifest." Even more pronounced is the failure of Citibank – which bears the burden of demonstrating federal preemption (see *Perdue v. Crocker Bank*, *supra*, 38 Cal.3d at p. 937) – to establish that application of California's ban on late charge fees unrelated to actual damages will in any sense "incapacitate" it from carrying out its duties as a federal instrumentality.

## CONCLUSION

Professor Geoffrey Miller, an authority on the American banking system and its history, commenting on the revolution sweeping the industry, has observed that "It is sobering, if edifying, to realize that banking, the world's most regulated industry, is evolving in almost blithe disregard of regulatory constraints. The industry has changed through the use of previous dormant statutory powers, through the aggressive manipulation of loopholes, or (sometimes) in apparent disregard of well-established legal principles. But legislators and the regulators have not forced the action. They have been relegated to cleaning up after the party – closing loopholes, ratifying changes that have occurred extralegally, or removing regulatory constraints in order to allow banks and thrift institutions to survive competition from their unregulated rivals. 'Deregulation' has indeed taken place, but it has not been the result of deliberate policy initiatives on the part of the legislative or executive branches." (Miller, *Interstate Banking in the Court*, *supra*, 1985 Sup. Ct. Rev. at p. 180.)

It is difficult to imagine a more classic example of this diagnosis than the case before us. Late payment charges exacted by credit card issuing banks totaled almost \$2 billion in 1992, according to one industry source. (Credit Card News (Apr. 1, 1994) at p. 2.) A large part of this revenue, from what one authority has called the "massive interstate credit card exportation phenomenon," has gone to Citibank, easily the dominant credit card issuer in the interstate market, by exploiting what can only be called a loophole in the interstices of federal-state banking regulation. (See Burgess and Ciolfi, *Exportation or Exploitation? A State Regulator's View of Interstate Credit Card Transactions*, *supra*, 42 Bus. Law. at p. 936; see also the study, General Accounting Office, U.S. Credit Card Industry: Competitive Developments Need to be Closely Monitored (Apr. 1994) p. 27 [Citibank is the single largest issuer of Visa and Mastercard with over \$35 billion in billings].)

However valuable to the economy of South Dakota, that scheme is in derogation of the right of the California Legislature to ensure the welfare of its residents in their credit dealings, more or less as it sees fit. To paraphrase the high court's opinion in *Marquette*, *supra*, 439 U.S. at page 319, "any plea to alter § [30] . . . is better addressed to the wisdom of Congress than to the judgment of this Court." It is not for us to condone an evasion of California's laws or the primacy of its law making powers by the judicial legerdemain embraced by the majority.

ARABIAN, J.

# DISSENTING OPINION BY GEORGE, J.

I respectfully dissent.

The question before us is whether federal law precludes California from applying its state consumer protection laws to *late-payment charges* imposed upon California consumers by a national bank that is chartered in another state but is doing business in California. As I shall explain, I believe that the majority, in concluding that federal law prohibits the application of California law to such late-payment charges, has failed to recognize the clear distinction that traditionally has been drawn between such late-payment charges and charges that commonly are characterized as "interest."

## I

In analyzing the question before us, it is helpful to begin by placing the matter in perspective. As a general rule, of course, out-of-state corporations that conduct business in California ordinarily are subject to this state's consumer protection laws. (See, e.g., *California v. ARC America Corp.* (1989) 490 U.S. 93, 101.) Furthermore, although Congress clearly possesses the authority to exempt nationally chartered banks from the general operation of state law, as we explained in *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 937, "Congress has declined to provide an entire system of federal law to govern every aspect of national bank operations . . . [and] national banks have traditionally been 'governed in their daily course of business far more by the laws of the State than of the [n]ation. . . .'" (Quoting *National Bank v. Commonwealth* (1870) 76 U.S. (9 Wall.) 353, 362; see also

*McClellan v. Chipman* (1896) 164 U.S. 347, 357; *Anderson Nat. Bank v. Lockett* (1944) 321 U.S. 233, 248.) Thus, in the *Perdue* decision itself, we held that California properly could apply its state consumer protection laws in determining the invalidity of fees imposed by the defendant national bank for the processing of "bounced" or "NSF" checks (i.e., checks drawn on accounts with insufficient funds).

Although, as *Perdue* demonstrates, it is well established that federal law does not broadly preempt states from applying state law to the operations of national banks, at the same time it is quite clear that, under the federal statute at issue in this case (12 U.S.C. § 85 (hereafter section 85)), the *rate of interest* that may be charged on loaned funds is a subject as to which California may not apply its own state law in evaluating the validity of the actions of defendant Citibank. In *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299, the United States Supreme Court held that the State of Minnesota could not apply its own state law limits on the rate of interest (that could be charged on consumer credit card accounts) to a national bank whose home state was Nebraska. The high court concluded that, under section 85, the Nebraska national bank was entitled to impose a rate of interest authorized by Nebraska law even in its dealings with Minnesota residents. Thus, under the *Marquette* decision, it is clear that, because defendant Citibank is a national bank whose home state is South Dakota, California may not apply the limits on interest rates embodied in California law to restrict the rate of interest Citibank charges California consumers on their Citibank credit card accounts.

The *Marquette* decision, however, involved only the question of interest rates and did not address the issue whether section 85 applies to the type of late-payment fees at issue in the present case. As I shall explain, I believe that section 85, read as a whole and according to the ordinary meaning of its terms, does not support the majority's conclusion that the late-payment charges here at issue constitute "interest" within the meaning of that statute.

## II

Section 85 provides in relevant part: "Any [national bank] may take, receive, reserve and charge on any loan or discount made . . . *interest at the rate* allowed by the laws of the State . . . where the bank is located, or *at a rate* of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve Bank . . . , whichever may be the greater, and no more. . . . When *no rate* is fixed by the laws of the State . . . the bank may . . . charge *a rate* not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank . . . , whichever may be the greater. . . ." (Italics added.)

Section 85 includes no special definition of the term "interest" as used in the statute, and no indication that the term was used in other than its ordinary and commonly understood sense. As numerous cases have recognized, a late-payment charge that is set at a fixed-dollar amount unrelated either to the amount of the loan or the time period for which funds are advanced, and that is assessed only if the borrower fails timely to make a

required payment, ordinarily is not considered "interest." (See, e.g., *Tackett v. First Sav. of Arkansas, F.A.* (Ark. 1991) 810 S.W.2d 927, 931-932; *Rangen, Inc. v. Valley Trout Farms, Inc.* (Idaho 1983) 658 P.2d 955, 957-960; *Barbour v. Handlos Real Est. and Bldg. Corp.* (Mich. Ct.App. 1986) 393 N.W.2d 581, 587 (\$15 late-payment fee "do[es] not constitute interest".) Unlike a loan origination fee or other charge that its imposed by a lender without regard to the subsequent conduct of the borrower and that ordinarily would be included in calculating the "effective" rate of interest at which a loan is made, a late-payment fee that is assessed if, and only if, the borrower fails to make a timely payment during the period of the loan, properly is viewed as either a "penalty" or as "liquidated damages," imposed upon the basis of conduct that is within the control of the borrower. (See, e.g., *Garrett v. Coast Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 735-742 [holding that a late charge in a home loan contract does not constitute interest but instead reasonably must be viewed as either a penalty or liquidated damages].) Such a conditional or contingent late-payment charge or assessment traditionally has been distinguished from interest for purposes of determining whether a loan has been made at a rate in excess of the permitted rate of interest. (See, e.g., *First American Title Ins. & Trust Co. v. Cook* (1970) 12 Cal.App.3d 592, 596-597 [holding that \$5 late charge could not be regarded as interest on a loan for the purpose of determining whether the loan was usurious: "Whether a transaction is usurious must be determined as of the time of the transaction. An agreement which is not usurious in its inception cannot become so

by reason of the borrower's subsequent default. [Citations.] The penalty provisions as to which Cook now objects come into play only in the event of his default. Such payments are not regarded as interest on the loan itself, but as a penalty for nonperformance of a legitimate agreement. [Citation.]"; *Fox v. Federated Department Stores, Inc.* (1979) 94 Cal.App.3d 867, 884 [holding that late-payment finance charge on credit card account is not usurious: "Since the contract at its inception does not require a usurious payment, and it is only because of the customer's voluntary act in failing to make the payment when due that a finance charge is levied, under the applicable law such charge cannot be usurious."].)

There is absolutely nothing in section 85 that suggests that Congress, when it enacted this provision in 1864, intended the statutory reference to "interest" to include the type of late-payment fee at issue in the present case. Indeed, at the time of the 1864 enactment, the leading United States Supreme Court decisions on the subject made it quite clear that such a late-payment charge, whose payment was contingent upon the borrower's own conduct during the term of the loan, would not be considered interest for the purpose of determining whether the loan exceeded the legally permitted rate of interest. (See *Spain v. Hamilton's Administrator* (1863) 68 U.S. (1 Wall.) 604, 626 ["The payment of anything additional depends also upon a contingency, and not upon any happening of a certain event, which of itself would be deemed insufficient to make a loan usurious." (Italics added.)]; *Lloyd v. Scott* (1830) 29 U.S. (4 Pet.) 205, 224 ["If a party agree to pay a specific sum, exceeding the lawful interest, provided he do not pay the principal by a day certain, it is

not usury. By a punctual payment of the principal, he may avoid the payment of the sum stated, which is considered as a penalty." (*Italics added.*)]). Although the majority cites a few, isolated pre-1864 cases that held that, under some circumstances, such charges might be viewed as rendering a loan usurious (see maj. opn., *ante*, at p. \_\_\_ [typed maj. opn. at p. 18]), the very annotation cited by the majority states explicitly and unequivocally that "the general rule" at that time (and thereafter) was to the contrary, and corresponded to the above quoted statements of the United States Supreme Court in the *Spain*, *supra*, 68 U.S. 604, and *Lloyd*, *supra*, 29 U.S. 205, decisions. (See Annot. (1933) 82 A.L.R. 1213, 1214.) Under these circumstances, I believe it is unreasonable for the majority to conclude that, when enacted, the term "interest," as employed in section 85, was intended to encompass the late-payment charges here at issue.<sup>1</sup>

<sup>1</sup> Although the majority acknowledges that the *Spain*, *supra*, 68 U.S. 604, and *Lloyd*, *supra*, 29 U.S. 205, decisions indicate that a late-payment charge generally would not be considered in determining whether a lender had charged a usurious rate of interest, the majority suggests that those decisions are not inconsistent with its interpretation of section 85 because they do not indicate that a late-payment fee should not be considered "interest," but rather simply indicate that a late-payment fee should not be considered "unlawful interest." (Maj. opn., p. \_\_\_ fn. 8 [typed maj. opn. at pp. 18-19, fn. 8].) I believe the majority's suggestion reflects an unreasonable interpretation of the word "interest" as used in section 85. In my view, in providing in section 85 that a national bank may charge on any loan "interest at the rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank . . . , whichever is greater," Congress clearly was referring

## III

The majority maintains, however, that the term "interest" in section 85 must be given an unusually broad interpretation, encompassing late-payment fees, in order to effectuate the legislative purpose of the statute. It reasons: "If 'interest' were not read as indicated above, the purpose of facilitating a national banking system by granting national banks 'most favored lender' status in their home states could be frustrated by unfriendly state legislation. Thus, a state could allow periodic percentage charges payable absolutely by maturity for all lenders, including national banks, but fix them at a rate so low that they could lend only at a loss. It might then allow late

to those charges imposed by a national bank that were subject to and limited by laws establishing legal "rates of interest," and was not referring to other charges or fees that generally were not subject to the legal limitations imposed upon interest rates.

The conclusion that the term "interest," as employed in section 85, should not be interpreted to encompass late-payment charges is further supported by the circumstance that other federal statutes and regulations draw a clear distinction between interest and late-payment charges or fees. (See, e.g., 12 C.F.R. §§ 226.4(b)(1), 226.4(c)(2) (1995) (implementing 15 U.S.C. § 1605(a)(1)) [under federal Truth in Lending Act, "finance charge" includes "interest" but excludes "[c]harges for actual unanticipated late payment"]; 12 C.F.R. § 590.3 (1995) (implementing 12 U.S.C. § 1735f-7a) [with respect to federally related mortgage loans, state laws "expressly limiting the rate or amount of interest . . . shall not apply," but "[n]othing in this section preempts limitation in state laws on . . . late charges. . . ."]. See also *Seiter v. Veytia* (Tex. 1988) 756 S.W.2d 303 [federal statute eliminating interest rate limitations on loan secured by first liens on residential real property did not include late charges, and thus federal statute did not preempt application of state law to such late charges].)

payment fees to some lenders, *not including national banks*, at a level high enough that *they* could lend at a profit. Such a result would be untenable." (Maj. opn., *ante*, at p. — [typed maj. opn. at p. 20], original italics, fn. omitted.)

In my view, the foregoing reasoning of the majority is flawed in two distinct respects. First, I do not believe it is accurate to suggest that if section 85's reference to "interest" were interpreted *not* to include late-payment charges, a home state would be free to discriminate against national banks with regard to the imposition of such late fees. It has been quite well settled, since the early 1800's, that — even in the absence of a specific federal statutory prohibition — a state may *not* discriminate against a "federal instrumentality" either in the enactment or the enforcement of state laws, and a national bank, of course, is a federal instrumentality. (See *McCulloch v. Maryland* (1819) 17 U.S. (4 Wheat.) 316; *Farmers' and Mechanics' National Bank v. Dearing* (1875) 91 U.S. 29; *Memphis Bank & Trust Co. v. Garner* (1983) 459 U.S. 392, 397.)

Furthermore, if, absent the application of section 85, a home state lawfully *could* discriminate against a national bank (vis-a-vis its local state banks or other lenders) and desired to do so, a state would be able to discriminate with regard to a great variety of matters — from building permits to minimum wages to health and safety requirements — and yet no one reasonably could maintain that all of these matters should be characterized as "interest," within the meaning of section 85, simply because they are susceptible to discriminatory application. Thus, even if a state theoretically would be free (apart from section 85) to discriminate against a national

bank with regard to late-payment charges — a proposition I do not accept — that circumstance still would provide no logical basis for characterizing such charges as "interest" within the meaning of section 85.

Accordingly, I believe the majority has failed to demonstrate that the legislative purpose of section 85 justifies a departure from the ordinary reading of the statutory term "interest."<sup>2</sup>

## IV

In sum, I conclude that the word "interest," as employed in section 85, cannot properly be interpreted to apply to the late-payment charges at issue in this case. Of course, if Congress determines, as a matter of policy, that the validity of late-payment charges imposed by a national bank should be determined by the law of the national bank's home state, it may extend section 85 to

<sup>2</sup> I recognize that the majority's expansive interpretation of the word "interest," as employed in section 85, follows the lead of a number of lower federal and sister-state courts. (See maj. opn., *ante*, at p. — [typed maj. opn. at p. 24].) In *Greenwood Trust Co. v. Com. of Mass.* (1st Cir. 1992) 971 F.2d 818, perhaps the leading case in this line of decisions, the court relied upon a number of prior cases broadly interpreting section 85 to apply to a variety of bank charges or fees other than late-payment fees, and did not consider specifically whether, when the predecessor to section 85 was enacted in 1864, the statutory reference to "interest" was intended to encompass late-payment fees, as contrasted with the many other possible types of bank charges. (See 971 F.2d at pp. 829-830.) In any event, to the extent that prior decisions conclude that the term "interest," as employed in section 85, was intended to refer to such late-payment charges, I respectfully disagree for the reasons set out above.

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reach such late-payment charges. As currently written, however, I believe that the statute does not apply to such charges.

For the foregoing reasons, I would reverse the judgment of the Court of Appeal and permit plaintiff's action to go forward.

GEORGE, J.

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ORDER GRANTING REVIEW  
AFTER JUDGMENT BY THE COURT OF APPEAL  
Second Appellate District, Division Seven,  
No. B078913/B077960 - S041711  
IN THE SUPREME COURT OF THE  
STATE OF CALIFORNIA  
IN BANK  
(Filed Oct. 27, 1994)

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BARBARA SMILEY, Appellant

v.

CITIBANK (SOUTH DAKOTA), N.A., Respondent

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Appellant's petition for review GRANTED.  
Lucas, C.J. did not participate.

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Chief Justice

Mosk

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Associate Justice

Kennard

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Associate Justice

Baxter

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Associate Justice

Werdegar

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Associate Justice

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Associate Justice

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Associate Justice

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BARBARA SMILEY, Plaintiff and Appellant,  
v. CITIBANK (SOUTH DAKOTA) N.A.,  
Defendant and Respondent.

Smiley v. Citibank

No. B078913.

COURT OF APPEAL OF CALIFORNIA, SECOND  
APPELLATE DISTRICT, DIVISION SEVEN.

26 Cal. App. 4th 1767; 1994 Cal. App. LEXIS 710;  
32 Cal. Rptr. 2d 562; 94 Cal. Daily Op. Service 5333;  
94 Daily Journal DAR 9751

July 11, 1994, Decided

SUBSEQUENT HISTORY: As Modified August 11, 1994.

PRIOR HISTORY: Superior Court of Los Angeles  
County, No. BC059202, Melvin B. Grover, Judge.

DISPOSITION: The judgment is affirmed.

#### COUNSEL:

Chimicles, Jacobsen & Tikellis, Nicholas E. Chimicles,  
Michael D. Donovan, Chimicles, Jacobsen & Tikellis,  
Eugene Mikolajczyk and Patrick J. Grannan for Plaintiff  
and Appellant.

Shearman & Sterling, William M. Burke, Richard B. Ken-  
dall and Michael H. Strub, Jr., for Defendant and Respon-  
dent.

JUDGES: Opinion by Staniforth, J.,\* with Lillie, P. J.,  
concurring. Separate dissenting opinion by Johnson, J.)

\* Retired Associate Justice of the Court of Appeal, Fourth  
District, sitting under assignment by the Chairperson of the  
Judicial Counsel.

OPINION BY: STANIFORTH, J.\*

#### OPINION:

Appellant Barbara Smiley's (Smiley) class action  
seeks damages and injunctive relief alleging defendant  
Citibank (South Dakota) N.A. (Citibank)<sup>1</sup> charged exces-  
sive late charges on her (and others) Mastercard and  
Preferred Visa credit card accounts. Smiley alleges the  
fees charged are impermissible under California law. Cit-  
ibank contends Smiley's claims are "completely pre-  
empted under federal law."

The trial court first denied Citibank's motion to dis-  
miss, and Citibank then sought a writ of mandate in this  
court (Division Seven). This court issued its order and  
alternative writ of mandate directing the trial court to  
vacate its prior minute order denying Citibank's motion  
or to show cause why it did not do so. The trial court  
responded by entering judgment on the pleading and  
dismissing Smiley's action. Smiley appeals the judgment.

#### FACTUAL AND PROCEDURAL BACKGROUND

Citibank is a national banking association chartered  
by the United States Office of the Controller of Currency  
(OCC). Citibank issues credit cards to customers nation-  
wide from its sole location in Sioux Falls, South Dakota.

\* Retired Associate Justice of the Court of Appeal, Fourth  
District, sitting under assignment by the Chairperson of the  
Judicial Counsel.

<sup>1</sup> The complaint seeks both injunctive relief and damages  
and asserts causes of action under section 17200 of the Califor-  
nia Business and Professions Code, section 1671 of the Califor-  
nia Civil Code (which relates to liquidated-damages  
provisions), and California common law.

In addition to the "finance charge" on certain outstanding balances, Citibank's credit card agreements provide for "late charges" for customers who do not make minimum payments by certain specified dates.

Citibank charges are consistent with the express terms of Smiley's card agreements with Citibank. These charges are authorized under South Dakota law, where Citibank is located and where Smiley's account is maintained.

In August 1992, Citibank removed Smiley's action to the United States District Court for the Central District of California, upon the sole ground of diversity of citizenship. Citibank later sought to amend its removal petition to include the ground that Smiley's claims were preempted under federal law. Citibank filed its answer and affirmative defenses in federal court, denying every allegation of wrongdoing asserted by Smiley.

The federal court granted Citibank's motion to remand on the ground of lack of diversity. The federal court denied Citibank's motion to amend the removal petition as untimely. It therefore did not reach the merits of Citibank's preemption argument.

After remand, Citibank moved the trial court for a judgment on the pleadings dismissing with prejudice and without leave to amend all claims set forth in the complaint. The trial court denied Citibank's motion.

Thereafter, Citibank filed a petition for writ of mandate and other appropriate relief in this court (Division Seven) seeking an order commanding the trial court (1) to vacate its order denying Citibank's motion, and (2) to

enter a new order granting the motion. This court (Citibank v. Superior Court (Sept. 23, 1993) B077960 [nonpub. opn.] ) issued an order and alternative writ of mandate commanding the trial court to vacate its prior minute order denying Citibank's motion or, in the alternative, to show cause why it had not done so. The trial court vacated its previous order and issued its judgment of dismissal from which Smiley filed this appeal.

The trial court held that section 85 of the National Bank Act of 1864 governs Citibank's late payment fees on credit card accounts and that Smiley's claims, all of which were based entirely on challenges to Citibank's late charges under California law, were preempted.

## ISSUE

Does section 85 of the National Bank Act, 12 United States Code Annotated section 85, govern late payment fees that are charged by a national bank on credit card accounts, preempting any claim alleging that such charges violate the law of the state where the borrower resides?

## I

## DISCUSSION

Section 85 of the National Bank Act provides in relevant part: "Any association may take, receive, and charge on any loan . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located,

or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater. . . . " (12 U.S.C.A. § 85; hereafter section 85.)

Section 86 of the National Bank Act provides in part: "The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 86 of the title, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid. . . . " (12 U.S.C.A. § 86; hereafter section 86.)

Neither section 85 nor 86 defines the terms "interest" and "rate of interest". Smiley claims that late fees are not governed by sections 85 and 86. She argues that sections 85 and 86 govern the amount of interest national banks may charge and that because late fees are not interest, they are not governed by sections 85 and 86.

Multiple courts in interpreting sections 85 and 86 have treated a wide variety of charges as interest within the meaning of the statute. (See *Fisher v. First Nat. Bank of Omaha* (8th Cir. 1977) 548 F.2d 255 [cash advance fee]; *McAdoo v. Union Nat. Bank of Little Rock, Arkansas* (8th Cir. 1976) 535 F.2d 1050, 1056 [compensating balance requirements]; *Cronkleton v. Hall*, (8th Cir. 1933) 66 F.2d 384, 387, cert. den. (1933) 290 U.S. 685 [78 L.Ed. 590, 54 S. Ct. 121] [bonus or commission paid to lender]; *Northway Lanes v.*

*Hackley Union Nat. Bank & Trust Co.* (8th Cir. 1972) 464 F.2d 855, 863 [closing costs]; *Schumacher v. Lawrence* (6th Cir. 1940) 108 F.2d 576, 577 [taxes and recording fees]; *Panos v. Smith* (6th Cir. 1940) 116 F.2d 445 [same]; *American Timber & Trading v. First Nat. Bank of Ore.* (9th Cir. 1982) 690 F.2d 781 [compensating balance requirements]; *Nelson v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 794 F. Supp. 312, 318; *Ament v. PNC Nat. Bank* (W.D.Pa. 1992) 825 F. Supp. 1243.)

In *Fisher v. First Nat. Bank of Omaha*, *supra*, 548 F.2d 255, the court concluded that because section 85 allowed national banks located in Nebraska to charge interest at the rate allowed by state law, and because Nebraska law allowed some classes of state lenders to charge flat fees for loans, national banks located in Nebraska could also charge flat fees for loans. In its May 28, 1992 order, this Court held that under *Fisher*, interest under section 85 could not be defined narrowly to include only periodic interest charges, but included flat fees as well.

The United States Supreme Court upheld the *Fisher* court's holding in *Marquette Nat. Bank v. First of Omaha Corp.* (1978) 439 U.S. 299 [58 L. Ed. 2d 534, 99 S. Ct. 540]. The issue in *Marquette* was whether a national bank chartered in Nebraska could charge its Minneapolis credit card customers an interest rate that was allowed under Nebraska law, but was higher than the rate allowed by Minnesota's usury law. The Court held that under the plain language of section 85, a national bank could charge the rate of interest allowed by the state named in its organization certificate. The fact that the bank extended credit to residents of another state, the Court reasoned, did not alter the bank's location. (*Marquette*, 439 U.S. at p.

310 [58 L. Ed. 2d at p. 543].) Because section 85 allowed the bank to charge the interest allowed by Nebraska law, it overrode Minnesota's interest rate ceilings.

In *Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. 299, 308 [58 L. Ed. 2d 534, 541-542], the United States Supreme Court stated: "Omaha Bank is a national bank; it is an 'instrumentalit[y]' of the Federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States." *Davis v. Elmira Savings Bank*, 161 U.S. 275, 283 [40 L. Ed. 700, 701, 6 S. Ct. 502] (1896). The interest rate that Omaha Bank may charge in its BankAmericard program is thus governed by federal law. See *Farmers' & Mechanics' Nat. Bank v. Dearing*, 91 U.S. [(1 Otto.)] 29, 34 [23 L. Ed. 196, 198, 199] (1875)."

## II

Citibank's authority to engage in the banking business and, specifically, to establish credit card accounts, is based on the National Bank Act. (12 U.S.C.A. § 24 (Seventh); 12 C.F.R. § 7.7378 (1994).) The Act establishes a federal limit on lending charges by national banks (§ 85). If the section 85 limit is exceeded, section 86 provides the borrower's exclusive remedy: forfeiture of all interest due on the debt or, if the lender has already received the excessive interest, twice the amount of interest paid by the borrower. Thus sections 85 and 86 "cover the entire subject" of national bank lending. (*Farmers' & Mechanics' Nat. Bank v. Dearing* (1875) 91 U.S. (1 Otto.) 29, 32, 35 [23 L. Ed. 196, 198, 199].) As noted above, section 85 of the act further provides that national banks may charge "interest

at the rate allowed by the laws of the State Territory, or District where the bank is located." (12 U.S.C.A. § 85.) (Italics added.) Borrowers in California have a choice. They may elect to borrow money from a bank located in California or they may elect to borrow money from a bank located in a state other than California. If a borrower chooses to borrow money from a national bank located in a state outside of California, that national bank may assess the lending charges permitted by the laws of the state where it is located, even if the amount of such charges exceeds the amount permitted by California law, because California law is preempted. (See *Marquette Nat. Bank v. First of Omaha Corp.*, *supra*, 439 U.S. at p. 308 [58 L. Ed. 2d at pp. 541-542].)

## III

Twenty-four courts that ruled on the merits of the federal preemption defense raised by Citibank in this case have concluded that credit card late charges are "interest" governed by section 85.

In *Greenwood Trust Co. v. Com. of Mass.* (1st Cir. 1992) 971 F.2d 818, 830-831, cert. den. (1993) \_\_\_ U.S. \_\_\_ [122 L. Ed. 2d 138, 113 S. Ct. 974], the First Circuit held that both section 85 and the parallel federal statute governing state chartered banks insured by the Federal Deposit Insurance Corporation preempt Massachusetts law prohibiting late charges.

In *Tikkanen v. Citibank (South Dakota) N.A.* (D. Minn. 1992) 801 F. Supp. 270, 278-279, the court held that Citibank's late payment charges and over-credit-limit charges "are interest within the meaning of section 85

... [and that] Minnesota laws regarding late and over-limit fees cannot be enforced against national banks located in other states." (*Italics mine.*)

In *Hill v. Chemical Bank* (D.Minn. 1992) 799 F. Supp. 948 the district court held federal question jurisdiction existed because section 85 and federal statute governing lending by state-chartered banks apply to late and over-limit charges. In *Nelson v. Citibank* (South Dakota) N.A., *supra*, 794 F. Supp. 312, the court held that federal question jurisdiction existed because Citibank's late payment charges are interest governed exclusively by section 85. (See also *Goehl v. Mellon Bank* (DE) (E.D.Pa 1993) 825 F. Supp. 1239; *Ament v. PNC Nat. Bank*, *supra*, 825 F. Supp. 1243.)

## IV

Smiley's contention that California law should govern the permissibility of the late fees here at issue is directly contrary to the OCC's longstanding interpretation that section 85 mandates such matter is governed by the law of the state of the card-issuing bank. In addressing the very issue here presented, the OCC has repeatedly concluded that late fees are governed by section 85. (Statement of Interest of the United States at p. 7, citing letter from Robert Serino, OCC, Deputy Chief Counsel (Policy) p. 2 (Aug. 11, 1988-1989).)

The OCC is the exclusive administrator of the National Bank Act, and its interpretations of that Act are entitled to substantial deference. (*Nelson v. Citibank* (South Dakota) N.A., *supra*, 794 F. Supp. 312, 319; *Clarke v. Securities Industry Assn.* (1987) 479 U.S. 388, 403-404 [93 L. Ed.

2d 757, 771, 107 S. Ct. 750]; *Independent Bankers Ass'n of America v. Clarke* (8th Cir. 1990) 917 F.2d 1126, 1128-1129.) This deference is particularly appropriate because national banks rely on the OCC's guidance. (See *Zenith Radio Corp. v. United States* (1978) 437 U.S. 443, 457-458 [57 L. Ed. 2d 337, 347-348, 98 S. Ct. 2441]; *Independent Bankers Ass'n v. Marine Midland Bank* (2d Cir. 1985) 757 F.2d 453, 461, cert. den. (1986) 476 U.S. 1186 [91 L. Ed. 2d 554, 106 S. Ct. 2926].)

## V

Smiley's reliance upon *Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913 [216 Cal.Rptr. 345, 702 P.2d 503] is inapposite. The case is not in point. It does not involve section 85, or lending charges, or the preemptive scope of section 85.

In *Perdue*, the plaintiff filed a class action challenging the validity of charges imposed by Crocker National Bank (Crocker), a national bank located in California, for processing checks drawn on accounts without sufficient funds. (38 Cal.3d at p. 920.) Thus, the charges at issue in *Perdue* were not lending charges; they were charges associated with the bank's taking and receiving of deposits. Defendant bank was not an out-of-state bank but located in California. Consequently, the bank did not argue section 85 preempted California law. (See *Ament v. PNC Nat. Bank*, *supra*, 825 F. Supp. 1243, 1250.)

Similarly, not in point, are *People ex rel. Sepulveda v. Highland Fed. Savings & Loan* (1993) 14 Cal.App.4th 1692, 1709 [19 Cal.Rptr.2d 555]; *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731 [108 Cal.Rptr. 845,

511 P.2d 1197, 63 A.L.R.3d 39]; and *Beasley v. Wells Fargo Bank* (1991) 235 Cal. App. 3d 1383 [1 Cal.Rptr.2d 446]. Like the bank in *Perdue*, the banks in *Garrett* and *Beasley* were located in California. None of these cases addressed either preemption or section 85. Smiley cites those cases for the irrelevant proposition that Citibank's late charges violate California law. That question is, of course, not before the court, because the sole issue before the court is whether that California law is preempted.

We conclude the late charges here are governed solely by 12 United States Code Annotated sections 85 and 86. California law purporting to regulate such charges is preempted.

The judgment is affirmed.

Costs on appeal are awarded to respondent.

Lillie, P.J., concurred.

DISSENT BY: JOHNSON, J.

DISSENT:

I respectfully dissent.

For me, this is a more difficult case than the majority opinion might suggest. The authority holding late fees are "interest" under the National Bank Act (12 U.S.C. § 85, hereafter section 85) is thin and far from settled. Indeed it consists primarily of a single First Circuit case decided just two years ago, which, in turn, has been

followed by a few district court judges.<sup>1</sup> I am skeptical about the convoluted reasoning of the First Circuit opinion. Since a California appellate court is not bound by federal circuit court or district court opinions as to interpretations of federal law,<sup>2</sup> in my view this court should consider the language of section 85 anew and in doing so, reach a sensible definition of "interest." Under the construction the majority opinion accepts it is "caveat emptor" and a prayer for California consumers who sign up for credit cards issued by non-California banks.

The *Greenwood Trust Co. v. Com. of Mass.* (1st Cir.1992) 971 F.2d 818 (Greenwood) opinion employs a railroad metaphor, beginning with the first sentence. "This train wreck of a case arises out of a headlong collision between a state consumer-protection law and a federal banking law." (971 F.2d at p. 821.) Several pages later the train ride ends. "We need not grease the rails. . . . Given the imperatives of the Supremacy Clause, the whistle sounds loud and clear. The [state consumer protection law] must yield. It is preempted." (at pp. 830-831.)

<sup>1</sup> See, e.g., *Tikkanen v. Citibank (South Dakota) N.A.* (D.Minn. 1992) 801 F. Supp. 270, 278. *Ament v. PNC Nat. Bank* (W.D.Pa. 1994) 849 F. Supp. 1015 (removal to federal court ordered of lawsuit seeking recovery of excess interest and various fees and charges, including late fees); *Grunbeck v. Dime Sav. Bank of New York, FSB* (D.N.H. 1994) 848 F. Supp. 294.

<sup>2</sup> California Courts of Appeal are bound by decisions of the United States Supreme Court and of the California Supreme Court interpreting federal law. But they are not bound by circuit or district court decisions, although obviously those decisions are persuasive authority on federal questions. (9 Witkin, Cal. Procedure (3d ed. 1985) Appeal, §§ 779-780 pp. 750-751.)

Taking a ride on the First Circuit's railroad I don't hear the whistle at all. Maybe that's because there is no collision between California's consumer-protection law governing late fees and federal banking law, since the federal banking law is on another track. It is speeding down the "interest" track, while this state's laws and judicial decisions limiting late fees are chugging up the "penalty" track. Giving out-of-state banks a clear signal to charge whatever rate of interest their home state may allow on credit cards does not mean Congress intended state governments should be precluded from regulating other aspects of credit card transactions.

Greenwood did not involve section 85 of the banking law, directly. Greenwood Trust Company is not a federal bank governed by the national bank laws. Rather it is a state banking corporation chartered in Delaware. It markets a credit card, the "Discover Card," throughout the nation. Delaware law allows credit card companies to impose substantial late fees. Massachusetts, where a hundred thousand Discover Card customers reside, does not. When the Massachusetts government threatened a lawsuit, Greenwood countered with a complaint seeking to declare that federal law preempted the Massachusetts prohibition.

The federal law Greenwood Trust sought to invoke was a recent enactment seeking to place state financial institutions on an equal footing with federal financial institutions – section 521 of the Depository Institutions Deregulation Act of 1980 (DIDA). In the provision governing allowable interest rates, this new law tracked the language of section 85. The First Circuit initially held the identical language in the two statutes meant the same

thing. Then the court used section 85 and cases interpreting it to guide its construction of section 521 of DIDA. So the Greenwood opinion only deals with section 85 indirectly.

The First Circuit had to concede there were no published cases construing "interest" to include "late payment fees" under section 85. Furthermore, the court faced a further problem. "Interest at the rate allowed" – the language within section 85 under which it sought to place "late payment fees" – has a narrower meaning in common parlance. When someone is asked what interest rate they are paying on a loan, they respond "ten and a half percent" or "seven and three eighths percent." If it is a real estate loan, they might answer "ten and a half, and two points" (the up-front interest to obtain the loan). They might even add in the closing costs and appraisal fees, etc., the lender charged as part of the "interest" paid to obtain the funds.

But common citizens are unlikely to think of the "rate of interest" as including "late payment fees" they will not incur, unless and until they fail to make timely payments, as a part of the "interest" they are paying to obtain the loan. Instead late payment fees are costs, such as those which might accompany an attachment or foreclosure, which are contingent on a failure of performance on the part of the borrower. They are not what the ordinary citizen thinks of as part of the "rate of interest."

If the term "interest rate" (or "rate of interest") is given this common sense meaning within the context of section 85, that section clearly does not apply to "late

payment fees." As a consequence, section 85 which preempts state consumer protection laws only as to the "interest rate" out-of-state federal banks can charge would not preempt those state laws as to the "late payment fees" those banks can impose on delinquent borrowers.

In an effort to avoid the result dictated by the common meaning of "interest" and "rate of interest," the Greenwood opinion attempts to suggest Congress meant those terms to have a different, more technical, and broader meaning in section 85. The court does not delve into legislative history to prove this intent, however.<sup>3</sup>

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<sup>3</sup> The legislative history of the National Bank Act appears to lean in the opposite direction from the Greenwood definition of "interest." Congress did not write section 85 on a clean slate. The lawmakers chose to use the term "rate of interest" in section 85 at a time when the settled federal common law definition of "interest" specifically excluded contingent payments such as late fees. (*Lloyd v. Scott* (1830) 29 U.S. [9 Pet.] 205, [7 L.Ed. 833] [agreement to pay fixed additional payment if late in repaying loan is not considered "interest" but a "penalty"]; *Spain v. Hamilton's Administrator* (1863) 68 U.S. [1 Wall.] 604, 626, [17 L.Ed. 619, 625-626] [any payment which is contingent upon happening of an uncertain event is not part of "interest" and thus does not make a loan usurious].)

Not surprisingly, given the common understanding of the term "rate of interest", appellant's brief reports without contradiction from respondent, that the congressional debates are sprinkled with references to the "rate of interest" as solely a charge for money over time, with no mention of late charges or other contingent payments. Typically, a California congressman explained during the debate, "In California, the interest is by law, where no rate is expressed in the contract, ten percent per annum." (Cong.Globe, 38th Cong., 1st Sess. 1353 (1864).) Respondents refer us to nothing in the entire debate intimating

Instead it turns to a couple of dictionary definitions, both of which define "interest" as "' . . . a charge for borrowed money[,] generally a percentage of the amount borrowed.'" (971 F.2d at p. 824, quoting Webster's Ninth New Collegiate Dict. (1989) p. 630 [italics supplied by Greenwood court].)<sup>4</sup> The Greenwood court emphasizes that according to these dictionary definitions the common notion interest is a percentage of the amount loaned is only "generally" true. The court then assumes Congress intended the dictionary definition rather than what the term "rate of interest" might mean in common parlance – without even mentioning what definition of "interest" or "rate of interest" might have appeared in dictionaries more than a century ago when Congress first enacted section 85. From its finding Congress intended the dictionary definition of "interest," the Greenwood court then leaps to the conclusion the term "interest" in that statute can embrace "late payment fees."

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the national lawmakers were seeking to affect state regulation of late charges or other contingent fees. Nor do they point to anything in the debate suggesting Congress intended to adopt a definition of "rate of interest" which deviated from the common law definition the Supreme Court had reiterated only two years before congressional consideration of the National Bank Act. (38 Cong. Globe, 38th Cong. 1st Sess. 2122-2124.)

<sup>4</sup> The Greenwood opinion also cited but did not quote from the definition found in Black's Law Dictionary (6th ed. 1990). Black's defines interest as "the compensation . . . fixed by the parties for the use . . . of money." (Black's Law Dict. (5th ed. 1979) p. 729.) Interest is defined in Webster's Third New International Dictionary, Unabridged (1981) page 1178 as "the price paid for borrowing money generally expressed as a percentage of the amount borrowed paid in one year."

I will turn momentarily to the question of how the court justifies its conclusion the term "interest" in section 85 does include "late payment fees." But for now I question the reasoning employed to argue the dictionary definitions on which the Greenwood court relies even allows such a construction. Forgetting about whether "interest" inevitably must be expressed as a percentage of the amount borrowed, under these dictionary definitions the essential nature of "interest" remains. It is the "price paid" or "compensation received" for the use of money obtained for a period of time from the lender. Just because this price can be expressed as a flat fee instead of a percentage of the amount borrowed, or can be expressed as a mix of percentage and flat fee charges, or perhaps in some other imaginative way, does not alter its fundamental character as an amount of money the borrower pays the lender in return for the use of a sum of money the borrower receives.

A "late payment fee," on the other hand, is not a part of the compensation borrowers pay for the use of money. Black's Law Dictionary (incidentally one of the sources of the Greenwood court's definition of "interest") contrasts the two. "Interest" is "compensation . . . for the use . . . of money." (Black's Law Dict. (5th ed. 1979) p. 729, col. 2.) A "late payment fee," on the other hand, is "compensation for delay in payment." (at p. 730, col. 1.) Black's also points out a late payment fee "in essence is in the nature of a penalty." (Ibid.) "Late payment fees" likewise have been considered a "penalty" by the California Supreme Court. (*Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 739-740 [108 Cal.Rptr. 845, 511 P.2d 1197, 63 A.L.R.3d 39].)

A "late payment fee" is a contingent obligation most borrowers will never have to pay. It is one of several consequences borrowers may face for various breaches of their contract to repay the loan and the interest on the loan (which, in turn, is the compensation owed for use of the money). Depending on the nature of the loan and the contract, those consequences may include attachment of property, foreclosure of real estate, etc. Those consequences also may include payment of various additional fees and costs – not just "late payment fees," but the lender's legal fees and collection costs, the costs of the attachment or foreclosure, etc.

Are these additional contingent costs and consequences also to be considered part of "interest" within the meaning of section 85? Does this federal law preempt state regulation of those contingent costs and consequences, too? The logic of the Greenwood opinion would say yes. But I think not, for the reason they, like "late payment fees," are not part of the "compensation for the use of that money." These charges, like the "late payment fee," are in the nature of "damages" or "penalties" for breaching the loan contract rather than "compensation" due as part of the performance of that contract.

Since I do not consider the term "interest" within section 85 even encompasses "late payment fees," in my view this section would not authorize federal preemption of state laws regulating late payment fees. Thus, ordinarily I would not reach the rest of the Greenwood rationale. Or, to put it another way, if my view represents a proper construction of the term "interest" the remaining arguments in the Greenwood opinion are irrelevant. Those arguments cannot rescue the day for preemption if

Congress indeed intended to define "interest" either in its everyday meaning on the street or as its dictionary definitions are interpreted in this dissent.

But I do have some problems with the rest of the Greenwood rationale as well. Once having posited Congress intended some sort of open-ended definition of "interest" the court urges two alternative reasons for determining "late payment fees" are included in that definition. First, according to this opinion, under section 85 the home state of the bank not only determines the rate of interest its federal banks may charge in other states, it also defines the meaning of the term "interest." If that home state decides "interest" includes "late payment fees," then "late payment fees" are interest under section 85. Consequently, the home state's law broadly interpreting interest to include late payment fees preempts other states from regulating the late fees the federal banks based in that home state charge citizens of these other states on any loans, including credit cards, those federal banks arrange with their out-of-state customers. (721 F.2d at pp. 828-829.)

The Greenwood court points to no authority supporting this novel interpretation of section 85. I find it unnecessary to discuss the grave issues of unconstitutional delegation of Congressional power to state legislatures this construction raises. That is because, in my view, it appears highly unlikely Congress intended to leave the scope of federal preemption to the whim of a host of state legislatures. It is one thing for Congress to be seen as delegating to state legislatures the power to effectively determine certain rates within a precisely defined area which Congress has defined and permitted preemption. It

is quite another for Congress to delegate to state legislatures the power to define the length and width of the area in which they will be allowed to set rates which preempt other states' regulations.<sup>5</sup> Without a clear and unequivocal statement of congressional intent to make the latter, rather extraordinary form of delegation, it seems difficult to argue Congress did so. If Congress has not unequivocally expressed such an intent, certainly courts should be reluctant to do the delegating for them.

This interpretation of section 85 appears dangerous as well as improbable. If states are allowed to define "interest" as broadly as they like, "late payment fees" may only be the beginning. Anything which bears on the conditions of a loan conceivably can be brought within the elastic concept of "interest" the Greenwood court implicitly endorses. So long as a state legislature is willing to define a specific loan condition as an element of "interest" for purposes of its own lending institutions, it becomes "interest" for purposes of all federal banks based in that state. Consequently, when federal banks home-based in that state distribute credit cards – or otherwise lend money – to citizens in other states, the state

<sup>5</sup> This very concern was expressed when it was suggested Congress had delegated to state legislatures the power to define another term in the National Banking Act. The term in question was what constituted a "branch" of a bank. The United States Supreme Court rejected the notion Congress had left this definition affecting state jurisdiction to individual state legislatures. In doing so the high court observed that to do so would "make [state legislatures] the sole judges of their own powers." Our high court concluded Congress "did not intend such an improbable result." (*First National Bank v. Dickinson* (1969) 396 U.S. 122, 133-134 [24 L. Ed. 2d 312, 320, 90 S. Ct. 337].)

legislatures of those states are preempted from regulating that loan condition. In that way, the legislature of a small state, like South Dakota or Delaware, which is home base to a major credit card institution could use federal preemption to impose not just its interest rates but the bulk of its credit card laws across the length and breadth of the land.<sup>6</sup>

The Greenwood opinion, however, does not rely entirely on the argument Congress left the question of preemption's scope to 50 state legislatures. As an independent and sufficient ground, the court argues prior federal court decisions interpret the term "interest" within section 85 so broadly it can be deemed to encompass "late payment fees." The Greenwood opinion bases this conclusion on cases construing "interest" to include flat interest rates as well as percentage rates (*Fisher v. First Nat. Bank of Omaha* (8th Cir. 1977) 548 F.2d 255 [fee for cash advance]); certain up-front loan fees (*Panos v.*

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<sup>6</sup> I reemphasize a point made earlier. If the term "interest" means what this dissent urges it means in the context of section 85, then this prong of the Greenwood rationale falls of its own weight. State legislatures would lack the power to define "interest" so broadly it embraced "late payment fees." Even assuming state lawmakers were empowered to define the scope of preemption by defining what they included in interest, this power obviously is limited to the boundaries of the congressional definition of that term. For reasons discussed earlier, they could not extend preemption to "late payment fees" or other contingent consequences representing damages or penalties for breaching the loan contract rather than compensation for its performance. To put it another way, they could not by fiat declare "non-interest" to be "interest" and thereby impose their version of the law throughout the country.

*Smith* (6th Cir. 1940) 116 F.2d 445, 446-447 [taxes and recording fees]); and bonuses or commissions paid to the lender (*Cronkleton v. Hall* (8th Cir.) 66 F.2d 384, 387 cert. den. (1940) 290 U.S. 685 [78 L.Ed. 590, 54 S. Ct. 121]).

In my view, this argument fails because it neglects a vital distinction between the payments and fees defined as "interest" in these cases and the family of costs and consequences of which "late payment fees" are a member. The former are merely different forms of "compensation for the use of money." In contrast, the latter are different forms of "damages (or penalties) for failure to timely pay." The only thing the cases the Greenwood opinion cites teach us is that "interest" can embrace "compensation for the use of money" even when the compensation comes in the form of "points" or fixed payments or commissions or expenses or in the form of flat fees of various sorts tacked on to more typical percentage interest rates. These cases do not stand for the proposition "late payment fees" and like consequences of breaching the loan contract represent "interest" within the meaning of section 85. Thus, these cases supply no support as precedent or in logic for the leap the Greenwood court, and those courts which have followed in its wake, have taken over the vast gulf which separates interest for the use of money from damages for breach of a loan contract.

Although most federal courts have followed Greenwood, at least one published District Court opinion was highly critical of its reasoning. (*Copeland v. MBNA America, N.A.* (D.Colo. 1993) 820 F. Supp. 537.) In Copeland plaintiffs filed a class action in state court, nearly identical to the instant case, challenging late fees a Delaware bank imposes on its credit card holders. The bank

removed the case to federal court and the plaintiffs moved to remand to state court. The bank resisted remand on grounds there was complete federal preemption of the lawsuit under *Greenwood*. The Copeland court announced it "respectfully disagrees" and granted remand to the state court.

The Copeland court was careful to point out it was ruling on the narrow issue of remand and not the possible viability of a preemption defense after remand. Nonetheless, in order to decide the remand issue, the court found it necessary to dispute much of the reasoning in *Greenwood*.

"Courts are to assume that the legislative purpose is expressed by the ordinary meaning of the words used. . . . Because late fees are not charged on a percentage basis, the ordinary meaning of the word interest does not include late fees.

"In *Greenwood Trust*, . . . the court noted that the word 'generally' in Webster's qualified the definition so as not to exclude other possible meanings. [Citation.] Therefore it concluded that the plain meaning rule did not control. (Id.) The plain meaning of a word, however, is not determined by reference to variations on its ordinary meaning, but by the ordinary meaning itself, i.e., the way it is generally used.

"Legislative history offers little assistance. . . .

". . . .

"This court concludes that a proposition that is not obvious from the plain meaning of a statute's language, nor from the legislative history, simply cannot be

regarded as a clear manifestation of congressional intent." (*Copeland v. MBNA America, N.A.*, *supra*, 820 F. Supp. 537, 540-541.)

The Copeland court had no occasion to do so, but could just as well have added, that preemption itself does not occur unless there is a clear manifestation of congressional intent to preempt state laws. (*Cipollone v. Liggett Group, Inc.* (1992) \_\_ U.S. \_\_ [120 L. Ed. 2d 407, 112 S. Ct. 2608].)

I recognize this dissent has been devoted almost exclusively to discussion of a single circuit court opinion. However, this *Greenwood* opinion presented the full case for the interpretation the majority of this court has adopted. It is the rationale which has been followed or adopted by other courts in the past two years.<sup>7</sup> My

<sup>7</sup> The majority opinion also relies heavily on an administrative agency's interpretation that "rate of interest" in section 85 includes "late fees." (Maj. opn., ante, at p. 1773.) The office of the Controller of Currency indeed has come to that view in recent years (letter of Robert Serino, Office of the Controller of Currency, Deputy Chief Counsel (Policy)). Not that many years ago, however, the head of that same administrative office took the contrary position, ruling that under section 85 "Charges for late payments . . . are illustrations of charges which are made by some banks that would not properly be characterized as interest." (Letter of J. Saxon, Controller of the Currency (June 25, 1964).)

The current Office of the Controller of Currency interpretation does not warrant the degree of deference the majority opinion accords it for several reasons. This particular agency interpretation deals with "a pure question of statutory construction", which is a judicial prerogative and not one where administrative bodies offer special competence. (*INS v. Cardoza-Fonseca* (1987) 480 U.S. 421, 446 [94 L. Ed. 2d 434, 457, 107 S. Ct.

reasons for rejecting that case and for supporting a contrary view having been set forth in full, I urge our Supreme Court to examine this issue anew. The State of California and its citizens have much to lose by allowing the legislature of a far away state to dictate the penalties a powerful lending institution can impose on our state's consumers when they are late with a payment or otherwise violate some term of the credit card contract.

1207].) Furthermore, this agency has not been consistent in its interpretation of what is embraced in the term "rate of interest." "An agency interpretation . . . which conflicts with the agency's earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view." (at p. 446, fn. 30 [94 L. Ed. 2d at p. 457].) Finally, I note our Supreme Court found it quite possible - indeed most reasonable - to interpret the National Banking Act contrary to a firm Office of the Controller of Currency interpretation of disputed language. (*Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 933-937 [216 Cal.Rptr. 345, 702 P.2d 503] app. diss. (1986) 475 U.S. 1001 [89 L. Ed. 2d 290, 106 S. Ct. 1170].)

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**CITIBANK (SOUTH DAKOTA), N.A.**

**SUPERIOR COURT OF THE STATE OF CALIFORNIA  
 FOR THE COUNTY OF LOS ANGELES**

BARBARA SMILEY, On )	Case No. BC059202
Behalf of Herself and All )	
Others Similarly Situated, )	<b>ORDER GRANTING</b>
Plaintiff, )	<b>MOTION OF</b>
v. )	<b>DEFENDANT CITIBANK</b>
CITIBANK (SOUTH )	<b>(SOUTH DAKOTA), N.A.</b>
DAKOTA), N.A., )	<b>FOR JUDGMENT ON</b>
Defendant. )	<b>THE PLEADINGS</b>
)	Date: September 14, 1993
)	Time: 9:00 a.m.
)	Place: Department 32
)	(Filed Oct. 06, 1993)

On July 7, 1992, Plaintiff Barbara Smiley ("Plaintiff") filed her Complaint for Damages and Injunctive Relief (the "Complaint") in the Superior Court of the State of California in and for the County of Los Angeles against defendant Citibank (South Dakota), N.A. ("Citibank").

Citibank is a national banking association chartered by the Office of Comptroller of Currency (the "OCC"), which issues credit cards to customers nationwide from its location in Sioux Falls, South Dakota. In addition to the "finance charge" on certain outstanding balances, Citibank's credit card agreements provide for "late charges" for customers who do not make minimum payments by certain specified dates. Those late charge are assessed in the form of a fixed flat fee, or as a percentage of the customer's account balance, or both.

Plaintiff is a California resident who alleges that Citibank has assessed excessive late fees on her MasterCard and Preferred Visa credit card accounts. Although such charges are consistent with the express terms of her card agreements with Citibank and are authorized under South Dakota law, where Citibank is located and where Plaintiff's account is maintained, Plaintiff alleges that such fees are impermissible under California law. The Complaint seeks both injunctive relief and damages and asserts causes of action under section 17200 of the California Business and Professions Code, section 1671 of the California Civil Code (which relates to liquidated-damages provisions), and California common law.

On April 28, 1993, Citibank moved this Court for a judgment on the pleadings (the "Motion") dismissing with prejudice and without leave to amend all claims set forth in Plaintiff's Complaint on the ground that each of Plaintiff's state-law claims set forth in the Complaint is preempted by the National Bank Act of 1864, 12 U.S.C. § 21 *et seq.* Citibank initially noticed the hearing on the Motion for May 14, 1993. That hearing was continued to

June 22, 1993, and then continued by this Court to July 6, 1993.

On July 6, 1993, the Court heard argument on the Motion. Richard B. Kendall and Michael H. Strub, Jr., of Shearman & Sterling, appeared on behalf of Citibank. Patrick J. Grannan, of Chimicles, Burt, Jacobsen & McNew, appeared on behalf of Plaintiff. Following that hearing, on July 6, 1993, the Court entered a minute order denying the Motion.

On August 23, 1993, Citibank filed a petition for writ of mandate and other appropriate relief and a memorandum of points and authorities and exhibits in support thereof (collectively, the "Petition") with the Court of Appeal of the State of California, Second Appellate District (the "Appellate Court"). A copy of the Petition was served on and received by this Court. The Petition was assigned to Division 7 as case number B077960. By its Petition, Citibank urged the Appellate Court to direct this Court to vacate its Order denying Citibank's Motion and to enter a new and different order granting the Motion. On September 3, 1993, Plaintiff filed a memorandum of points and authorities in opposition to the Petition. A copy of Plaintiff's opposition was served on and received by this Court.

On September 7, 1993, the Appellate Court entered an Order and Alternative Writ of Mandate (the "Writ") directing this Court to vacate its July 6, 1993 Order denying Motion, and thereafter to make a new and different order granting said Motion, or, in the alternative, to show cause why the July 6, 1993 Order was proper.

In response to the Writ, this Court has carefully reviewed and considered the Petition, Plaintiff's opposition to the Petition, the memoranda of points and authorities and supporting declarations and exhibits annexed thereto submitted by the parties to this Court in support of and in opposition to the Motion, as well as the records, papers, and files in this case, and good cause appears for this Court to amend its July 6, 1993 ruling. Therefore,

**IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that:**

1. The National Bank Act, 12 U.S.C. § 85, sets forth the exclusive law governing the amount of "interest" that a national bank may charge on extensions of credit.

2. Section 85 provides that a national bank may charge "interest" on extensions of credit to customers anywhere in the nation at the rates allowed to lenders under the law of the state where the national bank is located.

3. Credit card late charges are "interest" as that term is used in section 85, and the National Bank Act therefore preempts state law to the extent that state law would affect the amount of credit card late charges that a national bank may charge.

4. Each of Plaintiff's claims set forth in the Complaint is based on a challenge to Citibank's late charges under California law. Therefore, each of Plaintiff's claims is preempted by the National Bank Act of 1864, 12 U.S.C. §§ 21 *et seq.*, and no cause of action in Plaintiff's Complaint states a legally cognizable claim for relief against Citibank.

5. For the foregoing reasons, Citibank's Motion is **GRANTED**, and all claims against Citibank in this action are dismissed with prejudice and without leave to amend.

Dated: OCT 06, 1993

MELVIN B. GROVER  
HON. MELVIN B. GROVER  
JUDGE OF THE SUPERIOR  
COURT

Submitted by:

SHEARMAN & STERLING

/s/ Richard B. Kendall

By: Richard B. Kendall

Attorneys for Defendant

CITIBANK (SOUTH DAKOTA), N.A.

#### PROOF OF SERVICE

STATE OF CALIFORNIA       )  
  ) ss.:  
COUNTY OF LOS ANGELES )

I, the undersigned, certify and declare that I am over the age of 18 years, employed in the County of Los Angeles, California, and am not a party to the within action; my business address is 725 South Figueroa Street, 21st Floor, Los Angeles, California 90017. On September 21, 1993, I served the foregoing document described as **[PROPOSED] ORDER GRANTING MOTION OF**

**DEFENDANT CITIBANK (SOUTH DAKOTA), N.A.**  
**FOR JUDGMENT ON THE PLEADINGS** on the inter-  
ested parties in this action as follows:

**PLEASE SEE SERVICE LIST**

*BY MAIL:* By placing a true copy thereof enclosed in a sealed envelope, and depositing same in the United States Mail with postage thereon fully prepaid. I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. Postage Service on that same day with postage thereon fully prepaid in Los Angeles, California in the ordinary course of business.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed at Los Angeles, California this 21st day of September, 1993.

/s/ J. J. Todd  
Jeanette Todd

**SERVICE LIST**

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SUPERIOR COURT OF THE STATE OF CALIFORNIA  
 IN AND FOR THE CITY AND  
 COUNTY OF LOS ANGELES

(Filed July 7, 1992)

BARBARA SMILEY, On	)	Case No. BC059202
Behalf of Herself and All	)	<u>CLASS ACTION</u>
Others Similarly	)	COMPLAINT FOR
Situated,	)	DAMAGES AND
	)	INJUNCTIVE RELIEF
Plaintiff,	)	1. Unlawful Business
vs.	)	Practices in Violation of
	)	California Business and
CITIBANK (SOUTH	)	Professions Code § 17200
DAKOTA), N.A.,	)	
Defendant.	)	

- ) 2. Breach of Duty of
- ) Good Faith and Fair
- ) Dealing
- ) 3. Violation of Civil
- ) Code § 1671
- ) 4. Unjust Enrichment
- ) and Imposition of
- ) Constructive Trust
- ) 5. Fraud and Deceit
- ) 6. Negligent
- ) Misrepresentation
- ) 7. Breach of Contract
- ) and Rescission
- ) Plaintiff Demands A Trial
- ) By Jury

Plaintiff, on behalf of herself and all others similarly situated, makes the following allegations on information and belief (except as to ¶¶ 5-7), based upon, *inter alia*, the investigation of her counsel.

### INTRODUCTION

1. Plaintiff brings this case on her own behalf and on behalf of all persons who held or currently hold a Citibank credit card, issued by defendant, while they were residents of California and while they maintained a California billing address, who have contracted for or been charged a late charge on such credit card account. Citibank has charged the plaintiff and other similarly situated persons (South Dakota), N.A. the late charges that are the subject of this action.

2. The defendant named herein advertises, markets, and/or distributes, either directly or through its subsidiaries, credit cards for which it charges exorbitant and unjustifiable late fees, and has been engaged in a long-term advertising, promotional and marketing campaign involving such cards that is false and misleading by its failure to disclose that such late charges are illegal and unconscionable. The defendant knew, recklessly disregarded and/or reasonably should have known of the impropriety of the late charges it imposed and continues to charge, but because of the heavy losses attributable to its loan portfolios, the defendant has engaged in a conspiracy to charge illegal and unconscionable late charges and to conceal from the public the impropriety of these late charges. While the defendant has attempted to assert the legitimacy of these late charges through further misrepresentations, claiming that its costs of collection have increased in recent years – primarily as a result of its own greed in indiscriminately issuing credit cards to non-creditworthy consumers during the 1980's – the defendant has failed to issue a statewide general warning about the illegality of the late charges or immediately halt the practice of imposing these exorbitant late charges, ostensibly for fear that its credit card business would generate less profits.

3. In California, there has been, until now, a virtual conspiracy of silence by the defendant – sometimes even resulting in overt misrepresentations – about the illegality and impropriety of these late charges.

4. This action seeks, among other remedies, appropriate damages and injunctive relief on a statewide basis in an effort to stop this conspiracy and the ongoing unfair

business practice conducted by the defendant, now resulting in widespread illegal and unconscionable late charges being paid by California consumers. Specifically, plaintiff challenges the imposition of certain late charges, in addition to already exorbitant interest rate levels charged for credit cards (now nearly four times the rate for a one year CD), without ensuring that such charges only equate to the actual damages incurred by this financial institution for the delinquent payment, or without providing consumers a warning as to the illegality and unconscionability of these late charges. This Complaint also seeks equitable and injunctive relief, including a statewide advertising campaign and/or a late charge refund, the imposition of a constructive trust on monies illegally obtained by the defendant, and to recover compensatory, statutory and/or punitive damages for the plaintiff class, as well as obtaining disgorgement and restitution from defendant of its ill-gotten gains for deceptive and unfair business practices unfair competition and false advertising, negligent misrepresentation, fraud and deceit, breach of contract and the covenant of good faith and fair dealing, and unjust enrichment, all resulting from defendant's conspiracy, common course of conduct and failure to disclose that the late charges it was imposing and continues to charge consumers are illegal and unconscionable.

#### PARTIES

5. Plaintiff Barbara Smiley is a resident of Los Angeles County, California. Plaintiff brings this action both in her individual capacity and on behalf of all others similarly situated against the named defendant. Plaintiff

was the holder of a Mastercard credit card issued by defendant at relevant times and is the holder of a Preferred Visa credit card issued by defendant. Plaintiff has been charged late charges by defendant in Los Angeles County on both her Mastercard and Preferred Visa account. In so doing, plaintiff either directly or indirectly relied upon, *inter alia* the representations, advertising, agreements and other promotional materials which were prepared and approved by the defendant and its agents and disseminated through advertising media and direct mail containing the misrepresentations and omissions alleged herein.

6. Defendant Citibank (South Dakota), N.A. ("Citibank") is a South Dakota chartered credit card bank with its principal place of business in Sioux Falls, South Dakota. Citibank is a wholly owned subsidiary of Citicorp, Inc., a bank holding company incorporated in Delaware and headquartered in New York, New York. Citibank actively solicits California residents to apply for and accept credit cards and has issued large numbers of credit cards to California residents.

7. In committing the wrongful acts alleged herein, the defendant has pursued a common course of conduct, acted in concert with, aided and abetted and conspired with other credit card issuers, in furtherance of a common plan, scheme or design to misrepresent and/or conceal the illegality and unconscionability of the late charges imposed upon California consumers, and thereafter to conceal and cover-up the wrongdoing, all for their own personal profit. Defendant actually knew of or recklessly or negligently disregarded the misrepresentations

and concealments at issue and actively participated in covering up their true effect.

### JURISDICTION AND VENUE

8. This court has jurisdiction over all causes of action asserted herein pursuant to the California Constitution, Article VI, § 10, because this case is a cause not given by statute to other trial courts.

9. This court has jurisdiction over defendant Citibank because it extensively solicits California residents and merchants to use and accept Citibank credit cards and it does sufficient business in California and avails itself of the California market to render the jurisdiction of the California courts permissible under traditional notions of fair play and justice.

10. The damages suffered and sought to be recovered by plaintiff and the class she seeks to represent in the aggregate are in excess of the jurisdictional minimum of this court (although the individual claims of every class member would not exceed this amount), but the exact amount of damages caused to the class members cannot be precisely determined without access to defendant's records. The individual value of the damages and injunctive relief sought for each member of the Class is substantially less than \$50,000 per person. Venue is proper in this court since plaintiff, as well as thousands of class members, entered into an agreement with the defendant or its agents or subsidiaries and otherwise engaged in the transactions which form the basis of this action by paying the late charges in question and/or by entering into an agreement for the use of the subject

credit cards distributed by defendant in Los Angeles County.

### CLASS ACTION ALLEGATIONS

11. Plaintiff brings this action on her own behalf and on behalf of all other persons similarly situated. The class which plaintiff seeks to represent is composed of all persons with California billing addresses who have contracted for or been charged a late charge in connection with the use of a Citibank credit card issued by Citibank.

12. The class is composed of thousands of persons, the joinder of whom is impracticable, and the disposition of its claims in a class action will benefit both the parties and the court. The class is sufficiently numerous, since the defendant advertises, promotes, distributes and collects late charges from credit cards issued directly to California consumers.

13. There is a well-defined community of interest in the questions of law and fact involved affecting the parties to be represented. The questions of law and fact common to the class predominate over questions which may affect individual class members, including the following:

(a) Whether the defendant perpetrated a fraud upon the class or committed a breach of contract by committing the acts and omissions detailed herein;

(b) Whether the defendant knew or recklessly or negligently disregarded that the late charges it contracts for, imposes and/or collects are illegal and unconscionable;

(c) Whether the defendant knowingly, recklessly or negligently charged the late charges in question by disregarding or concealing the illegality and unconscionability of such late charges;

(d) Whether the acts of the defendant violated, *inter alia* California Business and Professions Code §§ 17200 and 17500 and California Civil Code §§ 1670.5, 1671 and 1750, *et seq.*, and other state common and statutory laws;

(e) Whether the defendant allowed the charging of illegal and unconscionable late charges under false pretenses by misrepresenting or concealing that such late charges were, in fact, illegal and unconscionable; and

(f) Whether the class has been damaged and/or suffered irreparable harm and, if so, the extent of such damages and/or the nature of the equitable and injunctive relief, restitutional, compensatory damages or punitive damages to which the class is entitled.

14. By contracting and paying the illegal and unconscionable late charges imposed by defendant, plaintiff is asserting claims that are typical of the claims of the entire class, and plaintiff will fairly and adequately represent and protect the interests of the class in that she has no interests antagonistic to those of the class. Plaintiff has retained counsel who are competent and experienced in class action litigation.

15. Plaintiff and the class have suffered irreparable harm and damages as a result of defendant's wrongful conduct as alleged herein. Absent a class action defendant will likely retain the millions of dollars received

through its wrongdoing. Because of the small size of the individual class members' claims, few, if any, class members could afford to seek legal redress for the wrongs complained of herein. Absent a representative action, the class members will continue to suffer losses, the imposition of late charges will proceed without remedy and defendant will retain the proceeds of its ill-gotten gains. Even today the defendant continues to charge illegal and unconscionable late charges, thereby receiving further revenues and profits.

16. Notice of the pendency of this action can be given either by regular mail or by publication, which cost, under California law, can reasonably be imposed upon the defendant.

#### FACTS

17. The defendant charges a late charge of up to \$15.00 upon California consumers who use its credit cards, irrespective of the outstanding balance or amount owing on the credit card in question. This results in a substantial additional cost on the use of such cards, and is automatically imposed, even when a full payment is received just days after the initial due date.

18. There is a fundamental distinction between the interest charged by the defendant and the illegal and unconscionable late fee charges imposed by the defendant. Interest is a measure of compensation to which an obligee is entitled, while a penalty is punitive in character. The forfeiture attributable to a late charge is compelled without regard to the actual damages allegedly

sustained by the defendant as a result of the late payment, particularly when combined with the continuing exorbitant interest rate imposed by defendant on the outstanding balance. The late charges imposed upon California consumers by defendant are not calculated as the result of any reasonable endeavor by it to estimate a fair average damage that may be sustained by it as a result of the delinquency of the payment, since the late charges are assessed in addition to the continued payment of high interest and, on occasion, can practically equal the minimum payment due to the defendant, but in fact bear no relationship to the actual loss that allegedly is suffered by the defendant as a result of such late payments. The late charge imposed by defendant thus constitutes an illegal penalty in violation of California common and statutory law, including, *inter alia*, California Civil Code 1667, 1670.5 and 1671.

19. The primary purposes of these late charges are illegal - extracting from California consumers additional payments, which in actuality substantially exceed the damages allegedly suffered by the defendant, and to compel prompt payment through the threat of the imposition of charges bearing little or no relationship to the amount of the actual losses incurred by defendant. In some instances, these late charges, if calculated on an annualized basis as compared to the minimum payment due the defendant, result in additional charges which exceed 200% per annum or more. Even under the California Retail Installment Sales Act, California Civil Code § 1803.6, the maximum permissible delinquency charge that can be imposed on California consumers is \$5.00 per month or 5% of the installment due, *whichever is less*, and

even then such a charge may only be imposed once per delinquent payment. For credit card late charges, even though the minimum amount payable is generally as low as \$20.00 per month, the late charges imposed grossly exceed this maximum charge, and are charged each month, irrespective of whether the credit card has been used by the unsuspecting consumers, whether additional charges have been incurred in the interim, or whether the payment was simply several days late.

20. The late charges imposed by the defendant in connection with the use of its credit cards are also unconscionable. The defendant enjoys superior bargaining position over all members of the class as a result of its greater economic power, knowledge, experience and resources. Class members who are forced to utilize credit cards for the majority of their major consumer purchases have no alternative but to acquiesce in the relationship as offered by the defendant or to accept a similar, if not exact, arrangement with another bank or similar financial institution, which arrangements impose a late charge. Consumers' acquiescence to these transactions are hardly a luxury. For the person without a credit card, it is difficult, if not impossible, to rent a car, stay at a hotel, reserve tickets to a theater or sporting event, travel without excessive amounts of cash or engage in many other routine activities of modern society. Yet, despite the necessity of maintaining a credit card in our increasingly cashless society, in this totally one-sided transaction, consumers have absolutely no right to alter the relationship between themselves and the financial institutions without terminating the relationship altogether. Thus, defendant's

cardholders agreement is an adhesion contract containing unduly oppressive and unconscionable provisions.

21. The late charge imposed by the defendant is an unconscionable addition to the already exorbitant interest rates charged consumers. The great disparity between the actual cost to the defendant resulting from the alleged default and the actual amount charged by the defendant to consumers through imposition of late charges, in light of the absence of any equality of bargaining power, open negotiation, full disclosure and a contract which clearly and fully sets out the rights of the parties, unreasonably and oppressively imposes excessive and unfair liability upon the plaintiff and the members of the class, evidencing the unconscionability of the late charge provision. This has been borne out in a series of actions brought against financial institutions throughout the United States, in which such late charges have consistently been held illegal and unconscionable.

22. The defendant in its credit card advertising material and contracts does not fully, or sometimes at all, disclose the possibility of late charges, the amount of the late charge, in what circumstances late charges will be imposed, the purpose for such late charges, or that the amount of the late charge may greatly exceed the actual cost of collection. Even where there is such disclosure, it is provided in print so small that many consumers cannot read it, and is in general not provided to consumers before the consumer has even obtained the credit card. As a result, consumers are likely to be deceived by the materials disseminated by the defendant, in the defendant's attempt to obtain additional users of its profitable credit cards. Through the defendant's acts of deception,

the defendant has thus engaged in substantial acts of unfair competition.

23. The defendant has continued its practice of charging illegal and unconscionable late charges and conducting its long-term, false and misleading advertising and promotional campaign. The defendant has failed and refused to stop its illegal and unconscionable activities. In fact, the defendant charged plaintiff with late fees within the applicable limitations period.

#### **FIRST CAUSE OF ACTION**

##### **(Unlawful Business Practices In Violation Of California Business And Professions Code § 17200, et seq.)**

24. Plaintiff incorporates by reference ¶¶ 1-23 of the Complaint.

25. California Business and Professions Code § 17200 provides that unfair competition shall mean and include all "unlawful . . . practice." The defendant has violated § 17200 in that it has and continues to advertise, promote, impose and collect unconscionable and illegal late charges on the credit cards it has issued to California consumers, as explained more fully above.

26. By committing the acts alleged herein, the defendant has engaged in an unlawful business practice within the meaning of California Business and Professions Code § 17200.

27. In addition, defendant's use of various forms of advertising, including the print and broadcast media, to advertise, call attention to or give publicity to the sale of

services in a deceptive manner by not disclosing the illegality and unconscionability of the late charges in question constitutes unfair competition, and unfair, deceptive, untrue or misleading advertising, and thus an unlawful business practice within the meaning of California Business and Professions Code § 17200. Defendant's advertisements have deceived and/or are likely to deceive the consuming public, in violation of, *inter alia* California Business and Professions Codes §§ 17200 and 17500.

28. Plaintiff is informed and believes that the unlawful, unfair and fraudulent business practices of the defendant, as described above, present a continuing threat to members of the public in that the defendant still systematically perpetrates a fraud upon members of the public by imposing illegal and unconscionable late charges while not disclosing that such charges are illegal and unconscionable, bilking California consumers of millions of dollars in the process.

29. Pursuant to California Business and Professions Code §§ 17203 and 17535, plaintiff seeks an order of this court enjoining the defendant from continuing to engage in, use, or employ its practice of contracting for, charging and collecting unconscionable and illegal late charges or to prohibit the defendant from refusing to disclose such misrepresentations or provide a clear and reasonable warning of the illegality and unconscionability of the late charges; and additionally requests an order awarding plaintiff and the members of the class restitution of the money wrongfully acquired by the defendant by means of such false advertising and misrepresentations, plus treble damages, interest, and attorneys fees and costs

pursuant to, *inter alia*, C.C.P. § 1021.5, so as to restore any and all money to plaintiff and the members of the class which was fraudulently acquired and obtained by means of such unfair competition and which funds are still retained by the defendant. Plaintiff and the class additionally request that such funds be impounded by the court or that a constructive trust be imposed on such monies to avoid dissipation and/or fraudulent transfers of such monies by the defendant. Plaintiff and the class may be irreparably harmed and/or denied an effective and complete remedy if such an order is not granted.

30. The defendant has caused irreparable harm for which there is no plain, speedy or adequate remedy at law.

### SECOND CAUSE OF ACTION

#### **(Breach Of Duty Of Good Faith And Fair Dealing)**

31. Plaintiff incorporates by reference ¶¶ 1-30 of the Complaint.

32. The defendant owes to all California consumers who have obtained credit cards from them an implied duty to deal with such persons fairly and in good faith.

33. Plaintiff is informed and believes that throughout the class period, defendant has established and maintained a uniform policy for charging illegal and unconscionable late charges which, in intent and in practice, is arbitrary, capricious, and oppressive since such charges bear absolutely no relationship to the costs actually incurred by defendant. Said policy and the facts and practices conducted by the defendant pursuant thereto

violate the duty the defendant owes to its customers to deal with them fairly and in good faith in that such charges are set without regard for: (1) the amount of additional interest incurred on the account while the payment is outstanding; (2) the amount and type of labor involved in collecting delinquent accounts; (3) the actual cost to the defendant of not timely receiving payments; and (4) the minimum payment due upon which the defendant imposes a late charge. Customers of the defendant have no ability to affect the amount or method of calculation of said charges, because of the defendant's superior bargaining position and its take-it-or-leave-it policy. A significant purpose of the defendant's policies and practices regarding the setting of late charges is to unconscionably increase defendant's income and profit at the expense of California consumers.

34. As a result of the foregoing, plaintiff and the class are entitled to compensatory damages, plus interest, attorneys' fees and costs.

### THIRD CAUSE OF ACTION

#### **(Violation of Civil Code § 1671)**

35. Plaintiff hereby incorporates by reference ¶¶ 1-34 of the Complaint.

36. As a result of having no reasonable basis for the amount of the late charges it imposes upon plaintiff and the class, and because these late charges bear no reasonable relationship to the actual damages suffered by the defendant as a result of a late payment, defendant has violated California Civil Code § 1671.

37. As a result of the foregoing, plaintiff and the class are entitled to the amount of all late charges they have paid which were collected by the defendant, less any actual damages resulting from the alleged default which triggered the late charges in question. Plaintiff is also entitled to an award of interest, attorneys' fees and costs pursuant to, *inter alia*, California Civil Code § 1021.5.

#### FOURTH CAUSE OF ACTION

##### **(Unjust Enrichment And Imposition Of Constructive Trust)**

38. Plaintiff hereby incorporates by reference ¶¶ 1-37 of the Complaint.

39. As a result of the tortious conduct described above, the defendant has been and will be unjustly enriched at the expense of the members of the class. Specifically, the defendant has been unjustly enriched by the receipt of hundreds of millions of dollars in revenues and profits from the imposition of illegal and unconscionable credit card late charges, which are promoted and sold through advertisements which misrepresent that because of reasons other than its actual cost, such charges are necessary to recoup costs necessary in collecting late payments. In addition for the reasons detailed above, these late charges are illegal and unconscionable.

40. Unless enjoined, plaintiff and the members of the class will be irreparably harmed, having been charged late charges with no reasonable basis therefor, and plaintiff believes the defendant may transfer and/or dissipate

the proceeds from such transactions beyond the jurisdiction of this court. The defendant should therefore be required to disgorge the profits it has obtained and will unjustly obtain at the expense of the members of the class as detailed above, and a constructive trust should be imposed on all revenues thus far obtained by the defendant as a result of its collection of illegal and unconscionable late charges in order to *inter alia*, prevent the dissemination of such funds.

#### FIFTH CAUSE OF ACTION

##### **(Fraud And Deceit)**

41. Plaintiff hereby incorporates by reference ¶¶ 1-40 of the Complaint.

42. Defendant's representations made through its long-term advertising, promotional and marketing campaign as particularized above were misleading or were likely to mislead because they misrepresent and do not disclose that the impermissibly high late charges imposed by the defendant were illegal and unconscionable.

43. Defendant's representations and omissions regarding the necessity of and basis for imposing late charges were made with knowledge or reckless disregard of the laws of this state prohibiting false and misleading advertisements, as well as the reasonable expectations of public consumers. Such representations were made with the intent to defraud and induce plaintiff's and all class members' reliance as evidenced by the request for and actual payment of such late charges.

44. Plaintiff and the class members, unaware of the falsity of defendant's fraudulent representations of said material facts paid the illegal and unconscionable late charges, reasonably relying upon the representations of the defendant.

45. As a proximate result of the defendant's active misrepresentations or concealments of material facts regarding the illegality and unconscionability of the late charges, plaintiff and the class have suffered damages through payment of said late charges. The total amount of damages suffered by plaintiff and members of the class as a result of its payments cannot be fully ascertained without access to defendant's records and will be proven at the time of trial.

46. Defendant's suppression and/or misrepresentation of the material facts set forth above defrauded plaintiff and the class, in violation of California Civil Code §§ 1572, 1709 and 1710, as well as principles of common law, for which plaintiff and members of the class are entitled to recover compensatory damages, interest, and attorneys' fees and costs.

47. Defendant's conduct described herein was done with conscious disregard of plaintiff's rights and with the intent to vex, injure or annoy plaintiff and members of the class such as to constitute oppression, fraud or malice under California Civil Code § 3294, entitling plaintiff and the members of the class to an award of punitive damages, in an amount appropriate to punish or set an example of defendant.

### SIXTH CAUSE OF ACTION

#### **(Negligent Misrepresentation)**

48. Plaintiff incorporates by reference ¶¶ 1-47 of the Complaint.

49. In making the representations of fact to plaintiff and the members of the class described herein, the defendant failed to fulfill its duty to disclose the material facts set forth above. Among the direct and proximate causes of said failure to disclose was the negligence and carelessness of the defendant.

50. Plaintiff, unaware of defendant's affirmative misrepresentations and its failure to disclose the fact that the late charges it was imposing were unconscionable and illegal, paid the improper late charges. Had plaintiff known the true facts, she would not have taken such action. By reason thereof, plaintiff and the other class members have suffered damages in an amount according to proof at the time of trial, plus interest, attorneys' fees and costs.

### SEVENTH CAUSE OF ACTION

#### **(Breach Of Contract And Rescission)**

51. Plaintiff incorporates by reference ¶¶ 1-50 of the Complaint.

52. Plaintiff and the members of the class, by obtaining credit cards issued by the defendant, entered into a written contract through which the defendant benefited by receiving millions of dollars in revenues and

profits. As part of the agreement, the defendant represented and agreed that any late charges imposed were charged in accordance with all applicable laws.

53. Plaintiff and the class were fraudulently induced by the defendant to enter into such agreements by affirmative misrepresentations which defendant knew were not true or recklessly or negligently disregarded as being not true. The defendant breached said contract by charging consumers an illegal and unconscionable late charge. The defendant made and/or conspired to or allowed to be made these misrepresentations with the intent to deceive plaintiff and members of the class into making such agreements to utilize said credit cards and/or pay such late charges. Plaintiff and the members of the class justifiably relied upon such representations in using said cards. Had plaintiff and the members of the class known of the true facts, they would not have used said cards, or would not have paid the late charges imposed by the defendant.

54. Plaintiff and the members of the class are therefore entitled to compensatory damages and/or rescission of the agreement and repayment of the late charges expended in consideration therefor, plus interest from the date of such payment, plus reasonable attorneys' fees and costs.

#### PRAYER FOR RELIEF

WHEREFORE, plaintiff, on behalf of herself and on behalf of the members of the class, prays for judgment

and relief on all Causes of Action against the defendant, as follows:

1. For an order certifying that the action may be maintained as a class action;
2. For compensatory and statutory damages in an amount to be proven at trial, including any damages provided for by statute, and interest thereon;
3. For punitive and/or treble damages;
4. For an order enjoining the defendant from pursuing the policies, acts, and practices complained of herein, requiring that the defendant provide public notice, a court-approved public information campaign, a clear and reasonable warning of the illegality and unconscionability of the late charges imposed and/or a refund of such late charges, and imposing a constructive trust upon defendant's ill-gotten gains and/or requiring defendant to make restitution to plaintiff and all members of the class and restore all funds acquired by means of any act or practice declared by this court to be unlawful or fraudulent, a violation of California or federal statutes or regulations or to constitute unfair competition or untrue, misleading or false advertising or violation of the Consumers Legal Remedies Act, and to disgorge all revenues and profits obtained thereby;
5. For reasonable attorneys' fees pursuant to, *inter alia*, C.C.P. § 1021.5;
6. For costs of this suit;
7. For interest on damages awarded to the class; and

8. For such other and further relief as the court deems just and proper.

Date: July 7, 1992

GREENFIELD & CHIMICLES

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SUPREME COURT OF NEW JERSEY  
A-103 September Term 1994

JAMES H. HUNTER, on behalf of  
himself and all others similarly  
situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

Argued February 15, 1995 – Decided November 28,  
1995

On certification to the Superior Court, Appellate  
Division, whose opinion is reported at 272 N.J.  
Super. 526 (1994).

Michael D. Donovan, a member of the Pennsylvania bar, argued the cause for appellant (*Spector Gadon & Rosen*, attorneys; Mr. Donovan and Ann Miller, a member of the Pennsylvania bar, of counsel; Mr. Donovan, Ms. Miller, Paul R. Rosen and Robert L. Grundlock, Jr., on the briefs).

Arthur R. Miller, a member of the Massachusetts bar, argued the cause for respondent (*Archer & Greiner*, attorneys; Mr. Miller and Sean T. O'Meara, on the briefs).

Marilyn A. Bair, Deputy Attorney General, argued the cause for *amicus curiae* Attorney General of New Jersey (James J. Ciancia, Acting Attorney General, attorney; Andrea M. Silkowitz, Assistant Attorney General, of counsel).

Richard P. Jacobson submitted a brief on behalf of *amici curiae* The States of Arizona, Delaware,

Louisiana, Nevada, Ohio, South Dakota, and Utah (*Dunn, Pashman, Sponzilli, Swick & Finerty*, attorneys).

Charles N. Riley submitted a brief on behalf of *amicus curiae* Consumer Action (*Tomar, Simonoff, Adourian & O'Brien*, attorneys).

Beverly R. Porway, Counsel, submitted a brief on behalf of *amicus curiae* Federal Deposit Insurance Corporation.

Charles N. Riley submitted a brief on behalf of *amici curiae* the States of Hawaii, Iowa, Maryland, Massachusetts, Pennsylvania, South Carolina, Vermont, West Virginia, and Wisconsin (*Tomar, Simonoff, Adourian & O'Brien*, attorneys).

Dennis R. Casale submitted a brief on behalf of *amici curiae* The New Jersey Bankers Association, American Bankers Association, American Financial Services Association and Consumer Bankers Association (*Jamieson, Moore, Peskin & Spicer*, attorneys).

Michael J. Dunne submitted a brief on behalf of *amici curiae* Visa U.S.A., Inc., and Mastercard International Incorporated (*Pitney, Hardin, Kipp & Szuch*, attorneys).

The opinion of the Court was delivered by HANDLER, J.

The facts and issues in this case are substantially similar to those in the companion case, *Sherman v. Citibank (South Dakota)*, N.A., \_\_\_ N.J. \_\_\_, rev'g 272 N.J. Super. 526 (1994), also decided today. Here, New Jersey credit-card holders challenge the legality of late-payment fees assessed by Greenwood Trust, a federally-insured state bank chartered in Delaware. The bank, on the other

hand, claims that it is permitted under the Depository Institutions Deregulation and Monetary Control Act to charge out-of-state customers the same interest rate and other lender-imposed charges it is authorized to charge its own customers.

The specific issues are framed by the contentions of the parties. Plaintiff is the named party in this class-action suit. As in *Sherman*, plaintiff argues that New Jersey's Retail Installment Sales Act, N.J.S.A. 17:16C-50, -54 (RISA) (since amended, L. 1995, c. 43) forbids federally-insured state banks that issue credit cards to New Jersey customers from charging late-payment fees, that defendant's advertising and cardmember agreements violate New Jersey's Consumer Fraud Act, N.J.S.A. 56:8-2, -19 (CFA), and that the imposition of late-payment fees constitutes a common-law breach of contract and conversion. Like the claims in *Sherman*, plaintiff's claims focus on whether the notion of interest includes late-payment charges.

Greenwood Trust, however, argues it is free to charge late-payment fees in New Jersey. It relies on section 521 of the Depository Institutions Deregulation and Monetary Control Act, 12 U.S.C.A. § 1831d (DIDA), which expressly mirrors section 85 of the National Bank Act, 12 U.S.C.A. § 85 (NBA), and provides that federally-insured state banks may charge borrowers "interest at a rate allowed by the laws of the State . . . where the bank is located." 12 U.S.C.A. § 1831d(a). Section 521 expressly preempts conflicting state "constitution[s] or statute[s]." *Ibid*. Because it is a federally-insured state bank chartered in Delaware, which includes late fees in its statutory definition of

interest, Greenwood Trust argues that RISA and plaintiff's other claims conflict with, and are preempted by, section 521. 272 N.J. Super. at 529-30.

The Law Division dismissed the complaint. The Appellate Division affirmed, 272 N.J. Super. 526, and we granted plaintiff's petition for certification. 138 N.J. 270 (1994).

For substantially the same reasons expressed in *Sherman*, we conclude that this State's usury law prohibiting banks from charging late fees does not conflict with the federal statute giving national banks and federally-insured state banks preferential treatment with respect to lending authority. We hold that DIDA does not preempt the New Jersey RISA's prohibition on late-payment fees, and, therefore, reverse the judgment of the Appellate Division.

# I

Although it is clear that Congress intended section 521 to preempt conflicting state usury provisions, federal preemption of state law requires an actual conflict, not merely a potential, speculative or hypothetical one. *Rice v. Norman Williams Co.*, 458 U.S. 654, 659, 102 S. Ct. 3294, 3298-99, 73 L. Ed. 2d 1042, 1049 (1982); *Brown v. Hotel Employees International Union*, 468 U.S. 491, 510, 104 S. Ct. 3179, 3185, 82 L. Ed. 2d 373, 389 (1963). An actual conflict arises when it is impossible to comply with both state and federal law, or when state law is an obstacle to the accomplishment of the full purposes and objectives of Congress. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 299-300, 108 S. Ct. 1145, 1150-51, 99 L. Ed. 2d 316, 325

(1988); *Feldman v. Lederle Lab.*, 117 N.J. 125, 135 (1991). However, courts faced with potentially conflicting state and federal statutes must attempt to harmonize them whenever possible. *Exxon Corp. v. Hunt*, 97 N.J. 526, 533 (1984) (citing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963); *Huron Cement Co. v. City of Detroit*, 362 U.S. 440, 80 S. Ct. 813, 4 L. Ed. 2d 852 (1960)). "Preemption of state law by federal statute is not favored 'in the absence of persuasive reasons - either that the nature of the regulated subject matter permits no other conclusion, or that Congress has unmistakably so ordained.'" *Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 317, 101 S. Ct. 1124, 1130, 67 L. Ed. 2d 258, 264-65 (1981) (quoting *Florida Lime & Avocado Growers' Inc.*, *supra*, 373 U.S. at 142, 83 S. Ct. at 1217, 10 L. Ed. 2d at 257).

Section 521 of DIDA provides that any federally-insured state bank may:

notwithstanding any State constitution or statute to the contrary which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill or exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State . . . where the bank is located, whichever may be the greater. . . .

[12 U.S.C.A. § 1831d(a).]

The language and purpose of section 521 essentially imitate that of section 85 of the NBA. See, e.g., *Copeland v. MBNA America Bank, N.A.*, Colo. (1995) (slip op. at 14). Courts and federal agencies have interpreted Section 521 as conferring on federally-insured state banks the same insulation from State usury laws that national banks have enjoyed for over 100 years under the NBA. *Greenwood Trust Co. v. Massachusetts*, 971 F.2d 818, 826-27 (1st Cir. 1992) (concluding that section 521 permits federally-insured state banks to "export" interest rates), *rev'g* 776 F. Supp. 21 (D. Mass. 1991); *Vanderweyst v. First State Bank*, 425 N.W.2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most-favored-lender" status), *cert. denied*, 408 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988); *Smiley v. Citibank (South Dakota) N.A.*, 44 Cal. Rptr. 2d 441, 465, 66 (1995) (Arabian, J., dissenting); *id.* at 467-68 (George, J., dissenting). Thus, "interest," as that term is used in the NBA and DIDA, should be construed uniformly. E.g., *Greenwood Trust*, *supra*, 971 F.2d at 827 ("historical record clearly requires a court to read the parallel provisions of DIDA and the Bank Act in *pari materia*"); see also *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384, 112 S. Ct. 2031, 2037, 119 L. Ed. 2d 157, 167 (1992) (finding that when legislature borrows exact phrase from existing statute, courts should adopt prior judicial interpretations of that phrase). As demonstrated in *Sherman*, the term "interest" in the NBA does not include late fees, \_\_\_ N.J. \_\_\_ at (slip op. at 5-26); *Smiley*, *supra*, 44 Cal. Rptr. 2d at 469 (George, J., dissenting). We conclude that "interest" in DIDA similarly does not include late fees.

Like section 85, the language in section 521 expressly refers to interest rates. It says nothing about other specific charges associated with lending money. Thus, it would be improvident to impute to Congress the intent to include in the statute a meaning it did not express. Moreover, as we discussed at length in *Sherman*, the legislative history surrounding DIDA's enactment indicates that Congress intended to preempt only state usury laws regarding traditional interest, namely, periodic percentage rates, not other specific charges. See *Sherman*, \_\_\_ N.J. at \_\_\_ (slip op. at 10-14); see also *Smiley*, *supra*, 44 Cal. Rptr. 2d 441, 465 (Arabian, J., dissenting).

The record of Congressional debate and deliberation concerning the enactment of DIDA is generally supportive of the notion that preemption of credit-card regulation under DIDA is confined to numerical interest rates. *Ibid.* Even if the sponsors and supporters of DIDA preemption provisions were shown to be committed to achieving total competitive equality of all lending terms offered by state banks and national banks, the simultaneous and persistent concerns of the bill's sponsors to preserve state consumer protection must likewise be acknowledged. During Senate consideration of the conference report on March 27, 1980, Senator Proxmire emphasized the limited preemptive scope of Title V.<sup>1</sup> This

<sup>1</sup> 126 Cong. Rec. S. 6900 (March 27, 1980):

I wish to reemphasize the point made initially in the Senate Banking Committee report that in exempting mortgage loans from State usury limitations, we intend to exempt only those limitations that are included in the annual percentage rate. We do not intend to exempt limitations on prepayment charges,

limitation, in DIDA's Title V, to annual percentage rates is clear from the Senate floor discussions of mortgage loans, from the Senate Banking Committee Report, and from the hearings on DIDA in the House of Representatives.<sup>2</sup>

## II

In this case, as in *Sherman*, the defendant relies on an agency interpretation of the statute to support its expanded notion of interest. However, to rely upon agency determinations in this case would be to undermine our responsibility to interpret the law by the views of an entity that has heretofore failed to provide a clear and consistent understanding of what Congress intended to include in its definition of interest. Far less than the usual amount of deference to an agency interpretation is

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attorneys' fees, late charges or similar limitations designed to protect borrowers.

<sup>2</sup> An official of the Federal National Mortgage Association, in response to an inquiry by Rep. St. Germaine, Chair of a House subcommittee considering DIDA, referred to the Senate Banking Committee Report cites above and stated:

This expression of legislative intent not to displace state laws designed for consumer protection with regard to charges other than charges treated as interest would leave in place those protective enactments in the various states that relate to prepayment penalties, late charges, regulations on disclosure of interest charges and restrictions on other costs in connection with loan transactions other than interest.

[Regulation Q. and Related Measures: Hearings Before the Subcommittee on Financial Institutions of the Committee on Banking, Finance and Urban Affairs, 96th Cong., 2d Sess. 125-26 (1980) (emphasis added).]

appropriate when that agency has failed to adopt a consistent interpretation in administering the statute in question. See *Sherman*, *supra*, \_\_\_ N.J. \_\_\_ at (slip op. at 21-23) (citing *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30, 107 S. Ct. 1207, 1221 n.30, 94 L. Ed. 2d 434, 457 n.30 (1987); *Watt v. Alaska*, 451 U.S. 259, 273, 101 S. Ct. 1673, 1681, 68 L. Ed. 2d 80 (1981); *General Elec. Co. v. Gilbert*, 429 U.S. 125, 143, 97 S. Ct. 401, 411-12, 50 L. Ed. 2d 343 (1976)); see also *Director, Office of Workers' Compensation Programs v. Manginvest*, 826 F.2d 1318, 1319-20 (3d Cir. 1987) (finding "ambiguities and inconsistencies in the Director's interpretation . . . of regulations . . . sufficiently great to preclude deference"); *Disabled in Action v. Sykes*, 833 F.2d 1113, 1117-19 (3d Cir. 1987), *cert. denied*, 485 U.S. 989, 108 S. Ct. 1293, 99 L. Ed. 2d 503 (1988); *Revak v. National Mines Corp.* 808 F.2d 996, 1002 (3d Cir. 1986) (rejecting deference arguments due to inconsistent agency interpretation of statute). Neither the Office of the Comptroller of the Currency (OCC), which regulates national banks, nor the Federal Depository Insurance Company (FDIC), the agency charged with the regulation of federally-insured banks, has issued consistent rulings concerning the interpretation of interest for purposes of the NBA and DIDA. See *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 23-26). But cf. *Copeland*, *supra*, \_\_\_ Colo. at \_\_\_ (slip op. at 13) (asserting that "[t]he OCC consistently has taken the position that late payment fees are interest" under both section 85 of the NBA and section 521 of the DIDA) (emphasis added). Inconsistent agency rulings should not be guides for a judiciary, the government branch principally responsible for the construction of statutes. See, e.g., *SEC v. Sloan*, 436 U.S. 103, 118, 98 S. Ct. 1702, 1711, 56 L. Ed. 2d

148 (1978); *Federal Maritime Comm. v. Seatrain Lines, Inc.*, 411 U.S. 726, 745-46, 93 S. Ct. 1773, 1784-85, 36 L. Ed. 2d 620, 633-34 (1973).

### III

In addition, New Jersey's State Bank Parity Act, N.J.S.A. 17:13B-1 to -2, does not authorize banks located in this State to charge late-payment fees in the guise of interest. *Sherman*, \_\_\_ N.J. at \_\_\_ (slip. op. at 28-31). Defendant contends, as did the defendant in *Sherman*, that because New Jersey credit unions are authorized to charge late fees to credit-card customers, N.J.S.A. 17:13-104b, New Jersey banks are so authorized pursuant to the State Bank Parity Act. That is simply not the case.

The State Bank Parity Act authorizes New Jersey banks to charge the same "rate of interest" charged by credit unions. N.J.S.A. 17:13B-2 provides, in pertinent part, that,

any bank, savings bank, savings and loan association or credit union may charge a rate of interest on any class or type of loan at the rate of interest permitted to any other lender by the laws of this State on that class or type of loan.

[N.J.S.A. 17:13B-2 (emphasis added).]

Although the Act provides for parity between the rates of interest charged by both banks and credit unions, the act does not explicitly authorize banks to charge other types of fees. Furthermore, there is no indication that the Legislature implicitly intended to authorize the imposition of such other fees in the State Bank Parity Act. See *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 28-32). There are

sound reasons grounded in public policy why the Legislature would choose not to equate interest charges with other imposed fees like late charges. For example, because small, individualized lenders, such as credit unions, serve their own members and do not cater to a large market, they cannot spread costs like banks. Thus, they must be permitted to take certain actions to insure their solvency, such as charging late-payment fees. *Ibid.*

We hold that Greenwood Trust has failed to demonstrate a Congressional intention to preempt state usury laws that prohibit discrete, specialized charges that do not directly affect the interest rate. Thus, there is no conflict between New Jersey's RISA statute and DIDA. Prohibiting either national banks or federally-insured state banks from charging late fees does not constitute discrimination because, at the time defendant procured those charges, New Jersey banks were likewise prohibited from assessing them. Unless Congress itself expressly provides otherwise through legislation, we find that New Jersey's RISA statute prohibits Greenwood Trust from charging New Jersey customers late fees.

We note, however, as we did in *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 39), that the late-charges at issue in this case were assessed prior to the enactment of L. 1995, c. 43, which amended the RISA to specifically allow for late-payment charges on retail charge accounts. The new statute, which took effect on May 29, 1995, applies prospectively only, and therefore is inapplicable to the late-payment charges at issue here. Nevertheless, we recognize that the newly amended RISA statute authorizes holders of retail charge accounts to charge late fees to customers. Thus, it would appear that N.J.S.A. 17:16C-42,

as amended, permits national banks and federally-insured state banks issuing credit cards to charge late-payment fees. *Sherman, supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 39-42). The charges at issue in this case, however, are not permissible because they were assessed prior to May 29, 1995, the date the amendment became effective.

## IV

The judgment of the Appellate Division is reversed.

Chief Justice Wilentz and Justices Stein, and Coleman join in Justice Handler's opinion. Justice Pollock has filed a separate dissenting opinion in which Justice Garibaldi joins. Justice O'Hern has also filed a separate dissenting opinion.

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SUPREME COURT OF NEW JERSEY  
A-103 September Term 1994

JAMES H. HUNTER, on behalf of  
himself and all others similarly  
situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

POLLOCK, J., dissenting.

This appeal focuses on the question whether late-payment fees are included in the definition of "interest" in the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C.A. § 1831d ("DIDA"). A related issue is whether the DIDA preempts state laws prohibiting late fees. As in the companion case, *Sherman v. Citibank (South Dakota), N.A.*, \_\_\_ N.J. \_\_\_ (1995), also decided today, the Law Division dismissed the complaint. The Appellate Division affirmed, 272 N.J. Super. 526 (1994). The majority reverses. I dissent.

-I-

The facts in this case are substantially similar to those in *Sherman*. James H. Hunter is the plaintiff in a class action challenging the legality of late fees charged to New Jersey holders of credit cards issued by Greenwood Trust, a federally-insured Delaware bank. Hunter argues that New Jersey's Retail Installment Sales Act of 1960, N.J.S.A. 17:16C-50, to -54 ("RISA"), forbids federally-insured state banks from charging late fees to New Jersey consumers.

He also argues that Greenwood Trust's cardmember agreement violates N.J.S.A. 56:8-2 and -19 (which prohibit consumer fraud), and that the imposition of late fees constitutes a common-law breach of contract and conversion. Like the claims in *Sherman*, Hunter's claims depend on whether interest includes late fees.

The DIDA, like the National Bank Act (NBA), which was the subject of *Sherman*, authorizes federally-insured state banks to charge borrowers "interest . . . allowed by the laws of the State . . . where the bank is located." Delaware's statutory definition of interest includes late fees: "If the agreement governing a revolving credit plan so provides, a bank may impose, as interest, a late or delinquency charge." *Del. Code Ann.* tit. 5, § 950 (1994). Thus, Greenwood Trust maintains both that the DIDA expressly authorizes charging late fees as interest and that the DIDA preempts conflicting state laws.

Hunter, however, contends that late fees are not interest under the DIDA. Specifically, he asserts that "interest" refers only to the periodic percentage rate charged on outstanding balances. He argues that his state-law claims do not conflict with the DIDA, and therefore that the DIDA does not preempt them. Alternatively, Hunter argues that the DIDA's express preemption clause preempts only his statutory, but not his common-law, claims.

-II-

This case requires us to determine the meaning of "interest . . . allowed by the laws of the State . . . where the bank is located," as that phrase is used in the DIDA.

Ultimately, matters of statutory construction involve a determination of congressional intent. *E.g.*, *Norfolk and Western Ry. Co. v. American Train Dispatchers Ass'n*, 499 U.S. 117, 128, 111 S. Ct. 1156, 1163, 113 L. Ed. 2d 95, 106-07 (1991); *Roig v. Kelsey*, 135 N.J. 500, 515 (1994). In the DIDA, Congress did not expressly define "interest." Nor does a fair reading of the legislative history disclose the intended meaning of that term.

As discussed more fully in my dissent in *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 6), the Civil War Congress enacted section 85 of the NBA to protect the newly-created national banking system from unfriendly state usury laws. Section 85 provides that any national bank

may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at a rate allowed by the laws of the State . . . where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater. . . .

[12 U.S.C.A. § 85.]

In *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 411-13, 21 L. Ed. 862, 863-64 (1873), the United States Supreme Court held, pursuant to section 85, that the defendant national bank could charge its borrowers the highest interest rate authorized to any lender in that state. The Court acknowledged that the "most favored lender" doctrine might disadvantage state-chartered banks, but relied on Congress's intent to create a strong

national banking system immune from hostile state legislation. *Id.* at 412-13, 21 L. Ed. at 863-64.

A century later, the Court determined that a national bank located in one state could charge its borrowers in other states the highest interest rate allowed to any lender in its home state. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978).

In the years following *Marquette*, interest rates soared. Although national banks could charge interest at a rate tied to the federal discount rate, local usury laws constrained state banks. See *Greenwood Trust Co. v. Massachusetts*, 971 F. 2d 818, 826 (1st Cir. 1992), *cert. denied*, \_\_\_ U.S. \_\_\_, 113 S. Ct. 974, 122 L. Ed. 2d 129 (1993). Congress rectified the imbalance by enacting the DIDA. *Ibid.*

Section 521 of the DIDA ("section 521") provides that

[i]n order to prevent discrimination against any [federally-insured state bank], such State bank may . . . notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State

. . . where the bank is located, whichever may be the greater. . . .

[12 U.S.C.A. § 1831d(a).]

The text of section 521 virtually mirrors that of section 85. Section 521 articulates Congress's intent that the purpose of the DIDA, like that of the NBA, is to prevent discrimination against federally-insured state banks. Unsurprisingly, courts and banking regulators have interpreted section 521 as protecting federally-insured state banks from hostile state laws, just as section 85 protects national banks from those laws. *Greenwood Trust, supra*, 971 F. 2d at 826-27 (concluding that section 521 permits federally-insured state banks to "export" interest rates); *VanderWeyst v. First State Bank*, 425 N.W.2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most favored lender" status), *cert. denied*, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988); Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep.* (CCH) ¶ 81,534 at 55,730 (July 8, 1992) (most favored lender and exportation principle); Letter by Frank L. Skillern, Jr., General Counsel, FDIC No. 81-3 (February 8, 1981) (most favored lender status); Letter by Kathy A. Johnson, Attorney, FDIC No. 81-7 (March 17, 1981) (exportation principle).

I agree with the majority, *ante* at \_\_\_ (slip op. at 6), that "interest," as that term is used in the NBA and the DIDA, should be construed uniformly. *E.g.*, *Greenwood Trust, supra*, 971 F. 2d at 827; see also *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 383-84, 112 S. Ct. 2031, 2037, 119 L. Ed. 2d 157, 167 (1992) (finding that when legislature borrows exact phrase from existing statute, courts

should adopt prior judicial interpretations of that phrase). Substantially for the reasons set forth in my *Sherman* opinion, \_\_\_ N.J. \_\_\_, I conclude that "interest" in the DIDA includes late fees.

Interpretations of the Federal Depository Insurance Company (FDIC), the agency charged with the regulation of federally-insured banks, 12 U.S.C.A. § 1811, support that conclusion. In my dissent in *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 1314), I noted that when Congress does not define a statutory term, courts should accept a reasonable interpretation of the term of the appropriate administrative agency. *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. \_\_\_, \_\_\_ 115 S. Ct. 810, 813, 130 L. Ed. 2d 740, 747 (1995); *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 843-44, 104 S. Ct. 2778, 2782-83, 81 L. Ed. 2d 694, 703-04 (1984); *Lammers v. Board of Educ.*, 134 N.J. 264, 274 (1993); *Metromedia, Inc. v. Director, Div. of Taxation*, 97 N.J. 313, 327 (1984); Kenneth C. Davis & Richard J. Pierce, Jr., *Administrative Law Treatise*, § 3.3 (3d ed. 1994) (discussing *Chevron*); Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 *Duke L.J.* 511, 516-18 (1989) (same). As described in my dissent in *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 16-18), the Comptroller of the Currency, which regulates national banks, has long ruled that interest could include late fees. Like the Comptroller, the FDIC has concluded that interest, for purposes of section 521, includes late fees that are authorized by a bank's home state. Letter from Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep. (CCH)* ¶ 81,534 at 55,730 (July 8, 1992). As in *Sherman*, I find that interpretation reasonable.

## -III-

Whether a federal law, such as the DIDA, preempts a state law is a matter of congressional intent. *E.g.*, *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, \_\_\_ 112 S. Ct. 2608, 2617-18, 120 L. Ed. 2d 407, 422-23 (1992). The inclusion of an express preemption clause unmistakably declares the intent of Congress to preempt conflicting state statutes. *Ibid.*

The DIDA, unlike the NBA, includes such an express preemption clause. Section 521 permits a national bank to charge interest at a rate allowed by its home state "notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section. . . ." The word "notwithstanding" suggests that Congress intended the DIDA to preempt conflicting state statutes. Thus, under the language of the DIDA's express preemption clause, the question is whether RISA's prohibition against late fees conflicts with section 521.

In *Sherman*, *supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 28), I concluded that section 85 conflicts with state laws, such as RISA, that prohibit late fees. I likewise submit that section 521 conflicts with state laws prohibiting such fees. Under its express preemption clause, the DIDA preempts Hunter's statutory claims.

I further determined in *Sherman* that New Jersey's State Bank Parity Act authorizes banks located in this State to charge interest in the form of late-payment fees. \_\_\_ N.J. at \_\_\_ (slip op. at 27-28); see Letter by Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994). Because I conclude that New Jersey banks may charge late fees to their New Jersey customers, I also

conclude that a state law prohibiting out-of-state federally-insured state banks from charging such fees impermissibly discriminates against those institutions. See *Sherman, supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 28). That conflict with the congressional intent to prevent discrimination against federally-insured state banks further supports my conclusion that the DIDA preempts state statutes that prohibit late fees.

-IV-

Hunter argues alternatively that even if the DIDA preempts his statutory claims, his common-law claims must survive. Specifically, he argues that the United States Supreme Court's holding in *Cipollone, supra*, 505 U.S. 504, 112 S. Ct. 2608, 120 L. Ed. 2d 407, limits the DIDA's preemptive scope to "State constitution[s] or statute[s]." 12 U.S.C.A. § 1831d(a). I disagree.

The Court recently addressed a comparable issue in *Freightliner Corp. v. Myrick*, 514 U.S. \_\_\_, 115 S. Ct. 1483, 131 L. Ed. 2d 385 (1995). In *Freightliner*, the Court clarified that *Cipollone* does not preclude implied preemption whenever Congress includes an express preemption clause in a federal statute. 514 U.S. at \_\_\_, 115 S. Ct. at 1487-88, 131 L. Ed. 2d at 393. "At best, *Cipollone* supports an inference that an express pre-emption clause forecloses implied pre-emption; it does not establish a rule." *Id.* at \_\_\_, 115 S. Ct. at 1488, 131 L. Ed. 2d at 393. The Court emphasized that a statute's preemptive scope is a function of congressional intent. *Id.* at \_\_\_, 115 S. Ct. at 1487, 131 L. Ed. 2d at 393.

I believe that Congress intended that section 521 of the DIDA should have the same preemptive effect as section 85 of the NBA. A recent interpretive letter by the FDIC further supports that conclusion. Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 93-27, *Fed. Banking L. Rep. (CCH)* ¶ 81,635 at 55,838 (July 12, 1993) (concluding that Congress intended to confer upon federally-insured banks the same protections that section 85 of the NBA confers on national banks). I conclude that Hunter's common-law claims, like his statutory claims, conflict with the DIDA and are preempted.

-V-

In *Sherman, supra*, \_\_\_ N.J. at \_\_\_ (slip op. at 28-29), I disagreed with the majority's conclusion that in the future, out-of-state federally-insured state banks may charge late fees on delinquent customers, but only up to \$10. Although I agree that those banks may charge such fees, I disagree that state law may limit the amount so charged. As a national banking law, the DIDA takes precedence over conflicting state law. Under the authority of the DIDA, Greenwood Trust may impose late fees as authorized by its home state, Delaware, without reference to another state's limitation on those fees. Consequently, the RISA's limitation on late charges must yield to the DIDA, as construed by the FDIC.

Accordingly, I respectfully dissent.

Justice Garibaldi joins in this dissent.

SUPREME COURT OF NEW JERSEY  
A-103 September Term 1994

JAMES H. HUNTER, on behalf of  
himself and all others similarly  
situated,

Plaintiff-Appellant,

v.

GREENWOOD TRUST COMPANY,

Defendant-Respondent.

O'HERN, J., dissenting.

I dissent for the reasons stated in my separate opinion in *Sherman v. Citibank*, \_\_\_ N.J. \_\_\_, also filed today.

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SUPREME COURT OF NEW JERSEY  
A-102 September Term 1994

MARC SHERMAN, on behalf of  
himself and all others  
similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant-Respondent.

Argued February 15, 1995 – Decided November 28,  
1995

On certification to the Superior Court, Appellate Division, whose opinion is reported at 272 N.J. Super. 435 (1994).

*Michael D. Donovan*, a member of the Pennsylvania bar, argued the cause for appellant (*Spector Gadon & Rosen*, attorneys; *Mr. Donovan* and *Ann Miller*, a member of the Pennsylvania bar, of counsel; *Mr. Donovan*, *Ms. Miller*, *Paul R. Rosen*, and *Robert L. Grundlock, Jr.*, on the briefs).

*Louis R. Cohen*, a member of the District of Columbia bar, argued the cause for respondent (*Dechert Price & Rhoads*, attorneys; *Mr. Cohen*, *George G. O'Brien*, *Matthew V. DelDuca*, and *Robert D. Rhoad*, on the briefs).

*Marilyn A. Bair*, Deputy Attorney General, argued the cause for *amicus curiae* Attorney General of New Jersey (*James J. Ciancia*, Acting Attorney General, attorney; *Andrea M. Silkowitz*, Assistant Attorney General, of counsel).

Richard P. Jacobson submitted a brief on behalf of *amici curiae* The States of Arizona, Delaware, Louisiana, Nevada, Ohio, South Dakota, and Utah (Dunn, Pashman, Sponzilli, Swick & Finerty, attorneys).

Irene E. Dowdy, Assistant United States Attorney, submitted a brief on behalf of *amicus curiae* Office of the Comptroller of the Currency (Faith S. Hochberg, United States Attorney, attorney).

Charles N. Riley submitted a brief on behalf of *amicus curiae* Consumer Action (Tomar, Simonoff, Adourian & O'Brien, attorneys).

Charles N. Riley submitted a brief on behalf of *amici curiae* the States of Hawaii, Iowa, Maryland, Massachusetts, Pennsylvania, South Carolina, Vermont, West Virginia, and Wisconsin (Tomar, Simonoff, Adourian & O'Brien, attorneys).

Mark L. First submitted a brief on behalf of *amicus curiae* Mellon Bank (DE), N.A. (Reed, Smith, Shaw & McClay, attorneys).

Dennis R. Casale submitted a brief on behalf of *amici curiae* The New Jersey Bankers Association, American Bankers Association, American Financial Services Association and Consumer Bankers Association (Jamieson, Moore, Peskin & Spicer, attorneys).

Jeffrey M. Keiser submitted a brief on behalf of *amici curiae* Trial Lawyers for Public Justice, P.C., and Bankcard Holders of America, Inc.

Michael J. Dunne submitted a brief on behalf of *amici curiae* Visa U.S.A., Inc., and Mastercard International Incorporated (Pitney, Hardin, Kipp & Szuch, attorneys).

The opinion of the Court was delivered by HANDLER, J.

In this case, as in the companion case of *Hunter v. Greenwood Trust Co.*, \_\_\_ N.J. \_\_\_, rev'g 272 N.J. Super. 526 (1994), also decided today, New Jersey credit-card customers contend that New Jersey's usury laws prohibit banks that issue those cards from charging late-payment fees to New Jersey customers.

The issues before us are more specifically framed by the claims and defenses of the respective parties. Plaintiff, as a named party in a class-action suit, challenges the legality of the late-payment fees that are charged to New Jersey holders of defendant Citibank (South Dakota) credit cards. Plaintiff argues that New Jersey's Retail Installment Sales Act of 1960, N.J.S.A. 17:16C-50, -54 (RISA), forbids national banks that issue credit-cards to New Jersey consumers from charging late-payment fees. Plaintiff also argues that defendant's failure to disclose in its cardmember agreements and advertising that late-payment fees are prohibited by New Jersey law violates New Jersey's Consumer Fraud Act (CFA), N.J.S.A. 56:8-2, -19. Finally, plaintiff contends that the imposition of late-payment fees constitutes a common-law breach of contract and conversion.

Defendant relies on section 85 of the National Bank Act (NBA), which provides that a national bank may charge borrowers "interest at a rate allowed by the laws of the State . . . where the bank is located." 12 U.S.C.A. § 85. Citibank is a national bank chartered in South Dakota, and South Dakota includes late-payment fees in its statutory definition of interest. 272 N.J. Super. at 438.

Citibank, therefore, contends that plaintiff's RISA claim, as well as plaintiff's other claims, conflict with, and are preempted by, section 85. *See id.* at 439. Thus, Citibank argues it is free to charge late-payment fees in New Jersey.

Following the commencement of this action, the Law Division granted the bank's motion to dismiss the complaint with prejudice. The Appellate Division affirmed. 272 N.J. Super. 435 (1994). We granted plaintiff's petition for certification, 138 N.J. 270 (1994), and now reverse the dismissal of plaintiff's claims.

We determine that the understanding of "interest" as expressed and authorized in the NBA does not include distinctive and contingent loan terms or charges, such as late fees, that are unrelated to interest rates. We hold that late-payment fees are not "interest" within the intent and purposes of the applicable federal statute. Rather, "interest at a rate allowed by the laws of the State . . . where the bank is located" refers only to the periodic percentage rate charged on outstanding balances. Therefore, plaintiff's state-law defenses to the bank's charges do not conflict with federal law, are not preempted, and the late-payment fees are illegal under New Jersey law.

# I

Since the early years of the Republic, the states have generally resisted the development of national banks and favored their own state-chartered banks through regulatory legislation. William Oscar Scroggs, *A Century of Banking Progress* 50-51 (1924); John J. Knox, *A History of*

*Banking in the U.S.* 12 (2d ed. 1969). The Supreme Court has, since *M'Culloch v. Maryland*, 17 U.S. (4 Wheat) 316, 4 L. Ed. 579 (1819), generally limited federal statutory involvement by construing preemption narrowly and giving relatively free rein to state usury law regulations. *See Anderson Nat'l Bank v. Lockett*, 321 U.S. 233, 64 S. Ct. 599, 88 L. Ed. 692 (1944); *McClellan v. Chipman*, 164 U.S. 347, 17 S. Ct. 85, 41 L. Ed. 461 (1896).

This Court, in considering preemption claims, must be cautioned by the longstanding presumption that "Congress did not intend to displace state law." *Maryland v. Louisiana*, 451 U.S. 725, 746, 101 S.Ct. 2114, 2129, 68 L. Ed. 2d 576, 595 (1981), and that it should not unnecessarily disturb "the federal-state balance." *United States v. Bass*, 404 U.S. 336, 349, 92 S. Ct. 515, 523, 30 L. Ed. 2d 488, 497 (1971). Indeed, greater restraint ought apply to preemption of spheres traditionally occupied by the states. Where the field that Congress is said to have preempted has been traditionally occupied by the states, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless there was the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S.Ct. 1146, 1152, 91 L. Ed. 1447 (1947).

"It is well settled that state usury law restrictions on lending practices are so extensive and historically rooted as to form part of the consumer protection terrain 'traditionally occupied' by the states." *Greenwood Trust Co. v. Massachusetts*, 776 F. Supp. 21, 27-28 (D. Mass. 1991), *rev'd*, 971 F.2d 818 (1st Cir. 1992), *cert. denied*, \_\_\_ U.S. \_\_\_, 113 S. Ct. 974, 122 L. Ed. 2d 129 (1993) (citing *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 38, 100 S.Ct. 2009, 2016, 64 L.

*Ed.* 2d 702, 713 (1980) ("We readily accept the submission that, both as a matter of history and as a matter of present commercial reality, banking and related financial activities are of profound local concern")); *Smiley v. Citibank (South Dakota), N.A.*, 44 Cal. Rptr. 2d 441, 465-66 (1995) (Arabian, J., dissenting) (same); *id.* at 467-68 (George, J., dissenting) (same). Accordingly, "[b]ecause consumer protection law is a field traditionally regulated by the states, compelling evidence of an intention to preempt is required in this area." *General Motors Corp. v. Abrams*, 897 F.2d 34, 41-42 (2d Cir. 1990) (upholding New York's "Lemon Law" against a claim that a Federal Trade Commission consent decree preempted major elements of the local law). Congress' failure to include an express exemption clause in section 85 necessitates a careful examination of whether the NBA conflicts with RISA's prohibition of late-payment fees.

Section 85 provides in pertinent part:

Any [national bank] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, *interest at a rate allowed by the laws of the State, Territory or District where the bank is located*, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater . . .

[12 U.S.C.A. § 85 (emphasis added).]

On its face, section 85 immunizes national banks that lend money beyond their home-state's borders from local

usury laws that might give local banks a competitive advantage. It also protects national banks during periods of inflation by overriding even the home-state's usury laws and permitting national banks to charge interest at a rate tied to the federal discount rate. *E.g.*, *Tiffany v. National Bank*, 85 U.S. (18 Wall) 409, 412-13, 21 L. Ed. 862, 863-64 (1874) (holding that Congress, by enacting NBA, intended to protect national banks from hostile state usury laws); *Roper v. Conserve, Inc.*, 578 F.2d 1106 (5th Cir. 1978), *aff'd sub nom., Deposit Guaranty Nat'l Bank v. Roper*, 445 U.S. 326, 100 S. Ct. 1166, 63 L. Ed. 2d 427 (1980) (holding section 85 was designed by Congress to mandate parity between national banks and local lenders). However, neither the plain meaning of the terms "rate" and "interest" in section 85, nor the legislative history of that provision indicates that these terms carry the expansive meaning inferred by defendant. *See Smiley, supra*, 44 Cal. Rptr. 2d at 469 (George, J., dissenting).

Since 1874, the Supreme Court has interpreted section 85 as entitling a national bank to charge the highest interest rate allowed to lenders by the laws of the state in which the bank is located. *Tiffany, supra*, 85 U.S. at 411-13, 21 L. Ed. at 863-64 ("The only mode of guarding against [state discrimination] was . . . to allow to national associations the rate allowed by the state to natural persons generally, and a higher rate"). Courts have recognized that *Tiffany* construed section 85 to place national banks in a position of limited advantage over state banks by allowing them to charge interest at the highest rate applicable under state law to lenders generally and not necessarily at a rate applicable to state banks, which might be lower. This ability to "borrow" an interest rate has come

to be known as the "most-favored-lender" doctrine. See, e.g., *Fisher v. First Nat'l Bank*, 548 F.2d 255 (8th Cir. 1977) (recognizing that notwithstanding limitations on interest imposed on state banks by Nebraska law, national bank located in Nebraska could legally charge, with respect to credit-card transactions, rates allowed by Nebraska law to small loan companies).

In *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978), the Supreme Court relied on the NBA and its most-favored-lender doctrine to allow a national bank chartered in Nebraska to charge its credit-card customers in Minnesota a rate of interest authorized in Nebraska, but prohibited by usury law restrictions in Minnesota. *Id.* at 313-15, 99 S.Ct. at 548-49, 58 L. Ed. 2d at 545-46. The *Marquette* Court recognized that the "exportation" of interest rates from a national bank's "home state" into a foreign state would "significantly impair the ability of the States to enact effective usury laws," but it found that such impairment "has always been implicit in the structure of the National Bank Act since citizens of one State were free to visit a neighboring State to receive credit at foreign interest rates." *Id.* at 318, 99 S. Ct. at 550, 58 L. Ed. 2d at 548 (citation omitted) (footnote omitted).

The Court, nonetheless, suggested Congressional action would be necessary to check the preemptive effect of the NBA in a time of national bank deregulation, tightened credit availability, and an increasingly nationalized credit-card lending system:

This impairment may in fact be accentuated by the ease with which interstate credit is available by mail through the use of modern credit cards.

But the protection of state usury laws is an issue of legislative policy, and any plea to alter § 85 to further that end is better addressed to the wisdom of Congress than to the judgment of this Court.

[*Id.* at 318-19, 99 S. Ct. at 550, 58 L. Ed. 2d at 548.]

*Marquette* does not mandate or encourage an extension of the "most-favored-lender" status to expand the definition of "rates" to include other non-interest rate charges. The national bank's authorized exportation of lending terms in *Marquette* was limited to numerical percentage-rate interest terms. The Court made no mention of the exportation of other credit-card terms, such as late charges, nor did its reasoning or rationale imply that discrete and specialized charges affixed to credit-card loans could be imposed on customers in other states. See *Smiley, supra*, 44 Cal. Rptr. 2d at 465 (Arabian, J., dissenting).

In the years following *Marquette*, Congress embarked on a mission to deregulate the banking industry. Interest rates soared, and while national banks could charge interest at a rate tied to the federal discount rate, state banks were constrained by local usury laws. See *Greenwood Trust, supra*, 971 F.2d at 826. Congress sought to rectify that obvious inequity by enacting the Depository Institutions Deregulation and Monetary Control Act of 1980, 12 U.S.C.A. § 1831d (DIDA). *Ibid.* The language of section 521 of DIDA essentially mirrors that of section 85 of the NBA. Courts and federal agencies have interpreted section 521 as conferring on federally-insured state banks the same insulation from state usury laws that national

banks have enjoyed under the NBA. *Id.* at 826-27 (concluding that Section 521 permits federally-insured state banks to "export" interest rates); *Vanderweyst v. First State Bank*, 425 N.W.2d 803, 806 (Minn.) (concluding that section 521 gives federally-insured state banks "most favored lender" status), *cert. denied*, 488 U.S. 943, 109 S. Ct. 369, 102 L. Ed. 2d 359 (1988).

The legislative history of DIDA is instructive to our understanding of Congress' general understanding of interest and its intent with respect to the notion of interest contained in the NBA. *E.g. Copeland v. MBNA America Bank, N.A.*, \_\_\_ Colo. \_\_\_ (1995) (slip op. at 14). Although the NBA was enacted 100 years earlier, the same tensions, namely parity between federal and state lenders and preservation of local usury laws, were present and these conflicting considerations generated substantial concerns surrounding the passage of the earlier banking statute.

The record of Congressional debate and deliberation concerning the enactment of DIDA strongly supports the understanding that preemption of credit-card regulation under DIDA is confined to traditional numerical interest rates. The central unifying purpose of DIDA was to provide for increased access to home mortgage loans. Section 501 of DIDA provided for preemption of state usury limits on mortgage loans in a manner virtually identical to the treatment of other loans (including credit-card agreements) in Title V of the Act, which contains section 521.

The Senate Report of deliberations over section 501 of DIDA restricts preemption and expressly reserves the regulation of "late charges" to the states.

In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.

[S. Rep. No. 96-368, 96th Cong., 2d Sess. 19, reprinted in 1980 U.S. Code Cong. and Ad. News, Vol. 2, 236, 255.]

Subsequent legislative history links preemption concerns in section 501 both to the consideration of section 521, and to DIDA in its entirety as passed on March 27-28, 1980. Notably, Congress passed section 501 at the same time, and the same title (Title V) of the same act, as section 521.

During the discussion on the Senate floor of the various bills that figured in the development of DIDA, Senators Pryor and Bumpers proposed an amendment, S. 1988, to give state-chartered institutions "competitive equality" with national banks by allowing them to charge interest at one percent above the federal discount rate. 125 Cong. Rec. 30655 (1979). Senator Proxmire, floor manager of the Senate bills under discussion, and chairman of the Senate Banking Committee, understood the proposed amendment to override state usury laws and emphasized that there was "a sharp division and difference of opinion in the Senate." *Id.*

Separate hearings on the Pryor-Bumpers initiative, S. 1988, 96th Cong. 1st Sess. (1979) were held December 17, 1979, and though it was not reported out of committee, the bill's language was substantially incorporated into

House Bill 4986, H.R. 4986, 96th Cong., 1st Sess. (1979), which was, in turn, enacted as DIDA. William M. Burke & Alan S. Kaplinsky, *Unraveling the New Federal Usury Law*, 37 *Bus. Law.* 1079, 1096-97 and n.102 (1982).

A fair reading of the legislative history indicates that Congressional concern was focused with particularity on numerical or percentage interest rates. In introducing S. 1988, Senator Pryor noted, "A national bank may charge one percent above the Federal discount rate, notwithstanding any State laws setting an interest-rate ceiling . . . [which] obviously discriminates in the strongest possible way against State banks." 125 *Cong. Rec.* 30655 (1979). The great bulk of the subsequent committee testimony and discussion indicates that the proposed preemption amendment was limited because, in Senator Pryor's words, it "would merely allow State chartered, federally insured banks . . . to charge the same interest rate as national banks." *Id.* In fact, there were only two references to wider displacement of state law though expansion of the "most-favored-lender doctrine." Senator Bumpers, co-sponsor of the preemption amendment, confined his remarks to numerical interest rate disparities and remarked pointedly, "I do not think it is particularly healthy to be overriding state law." *Id.*

Post-DIDA legislative history tends to confirm the conclusion that Congress in 1980 did not intend to bar states from prohibiting late fees by credit-card issuers. In 1981 and in 1983-84 the Senate (but not the House) passed amendments to DIDA which would have expanded preemption of state usury laws, but would have expressly exempted late charges from preemption. *Greenwood Trust*, *supra*, 776 *F. Supp.* at 31 (citing *Hearings on S. 730 Before the*

*Senate Committee on Banking, Housing and Urban Affairs*, 98th Cong., 1st Sess. (April 12, 1983); *Hearings on S. 1720*, 1981.<sup>1</sup> The failed S. 730 bill also expressly granted states the right to override preemption.

Thus, the fact that Congress was specifically concerned about effecting a preemption limited to numerical interest rates is significant. If we cannot attribute to legislative initiative of 15 years ago the intent to include

<sup>1</sup> S. 730, the "Credit Deregulation and Availability Act of 1983," would have amended Title V of DIDA to provide, in relevant part, as follows:

Sec. 531. The provisions of the constitution or laws of any State prohibiting, restricting, or in any way limiting the rate, nature, type, amount of, or the manner of calculating or providing or contracting for covered charges that may be charged, taken, received or reserved shall not apply to any extension of consumer credit made by the creditor.

Sec. 532. (a) As used in this part -

(1) The term "covered charges" means -

(A) interest, discount, points, a time price differential, or any similar fees, charges, or other compensation paid to the creditor and arising out of the credit agreement or transaction for the use of credit or credit services. *The term shall not include, however, fees, charges or other amounts paid to the creditor or arising out of the credit agreement or transaction that are paid or arise solely as the result of the failure or refusal of the debtor to comply with the terms and conditions of the debtor's agreement with the creditor, including without limitation the fact that the obligation is not repaid in accordance with the payment schedule. . . .*

[129 *Cong. Rec.* S. 17045-17046 (November 18, 1983) (emphasis added).]

discrete, specialized charges within a definition of interest, we cannot ascribe that expansive definition to a legislative initiative that occurred over 100 years earlier. That is especially so when the later statute substantially paralleled the language of the former, and it was passed in an effort to give federally-insured state banks status equal to national banks that had enjoyed a superior status since the enactment of the earlier act. Thus, it would be contrary to common sense to conclude that in enacting the NBA, Congress contemplated an open-ended and expansive concept of interest that was light years from the traditional understanding of a fixed, basic percentage rate applied to an unpaid loan balance. Or that, correlatively, it intended to prohibit states from regulating specific terms and conditions of loans and preventing lenders from charging late-payment fees.

## II

Defendant relies on case law from other jurisdictions to support its expansive interpretation of "interest", specifically, *Greenwood Trust*, *supra*, 971 F.2d 818 and *Tikkanen v. Citibank (South Dakota), N.A.*, 801 F. Supp. 270 (D. Minn. 1992). We find, however, that the reasoning expressed in the *Greenwood Trust* line of cases and the authorities cited by the *Greenwood Trust* court are unpersuasive and do not support the conclusion that Congress intended to include non-interest rate charges in its understanding of interest.

*Greenwood Trust* held that prior case law supported the notion that federal common law construes interest to encompass a variety of lender-imposed fees and financial

requirements that are independent of a numerical percentage rate. 971 F.2d at 829 (citing *American Timber & Trading Co. v. First Nat'l Bank*, 690 F.2d 781, 787-88 (9th Cir. 1982); *Fisher v. First Nat'l Bank*, 548 F.2d 255, 258-61 (8th Cir. 1977); *Panos v. Smith*, 116 F.2d 445, 446-46 (6th Cir. 1940); *Cronkleton v. Hall*, 66 F.2d 384, 387 (8th Cir.), *cert. denied*, 290 U.S. 685, 54 S. Ct. 121, 78 L. Ed. 590 (1933); *Nelson v. Citibank (South Dakota) N.A.*, 794 F. Supp. 312, 318 (D. Minn. 1992)). Inimical to the holding in *Greenwood Trust*, a careful examination of the cases cited does not establish that Congress intended to include late-payment fees within a federal definition of interest under either section 85 or section 521.

Contrary to the *Greenwood Trust* court's interpretation, *American Timber & Trading Co.*, *supra*, did not hold that a compensating-balance requirement was interest under section 85. Rather, the court held that a compensating-balance requirement reduces the principal amount of a loan for purposes of calculating effective interest. 690 F.2d at 787-88. In addition, *Fisher*, *supra*, did not expressly hold that cash-advance fees were interest under section 85. In that case, the plaintiff challenged the periodic interest and cash-advance fees charged by an out-of-state national bank. 548 F.2d at 256. The court applied the most favorable laws covering any class of lenders in the bank's home state, which permitted certain lenders to charge 30% interest on a balance under \$300, and held that the charges were not usurious. *Id.* at 258-61. The court did not even discuss the distinction between periodic interest rates and the flat fees charged.

In *Panos*, *supra*, the court did not hold that mortgage taxes and recording fees were interest under section 85.

Rather, the court held that such charges, which were deducted from the principal received by the borrower, reduced the principal amount of a loan for purposes of calculating effective interest. 116 F.2d at 446-47.

In *Cronkleton, supra*, the court did not conclude that a bonus or commission was interest under section 85. The Eighth Circuit's holding (in relevant part) was limited to a modification of the district court's award of damages for usury under the NBA. The court's opinion does not provide a detailed account of the facts. However, it appears that in February 1926, the defendant, a national bank, loaned \$55,000 to the plaintiffs. 66 F.2d at 385. The contractual periodic rate of interest was not usurious. *Ibid.* But, in November 1930, plaintiffs paid to the bank an additional \$1,000. *Ibid.* Although the district court "made no findings as to bonuses paid," the court characterized the additional payment as a bonus or commission. *Id.* at 386. The court then noted that "in determining the rate 'reserved' or 'charged' . . . the taking of a 'bonus' or 'commission' . . . may enter in to render an otherwise lawful rate unlawful and usurious." *Id.* at 387.

The *Greenwood Trust* court suggested that *Nelson, supra*, decided three months earlier, held that late-payment fees were interest under section 85. 971 F.2d at 829. However, *Nelson* expressly disclaimed that conclusion. 794 F. Supp. at 320 ("the question of whether national banks may export terms other than periodic interest charges goes to the merits of the case; deciding that question on a motion to remand is inappropriate"). The court held only that the defendant's claim that section 85 preempted plaintiffs' state law claims raised a substantial federal question. *Id.* at 315-16.

The court in *Greenwood Trust* also cited several cases to support the proposition that section 85 "adopts the entire case law of [a state bank's home] state interpreting the state's limitations on usury; it does not merely incorporate the numerical rate adopted by the state." 971 F.2d at 829 (citing *First Nat'l Bank v. Nowlin*, 509 F.2d 872, 876 (8th Cir. 1975); accord *Roper v. Conserve, Inc.*, 777 F. Supp. 508, 510-11 (S.D. Miss. 1990), *aff'd*, 932 F.2d 965 (5th Cir.) (table), *cert. denied*, \_\_\_ U.S. \_\_\_, 112 S. Ct. 181, 116 L. Ed. 2d 142 (1991); *Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549, 555, 20 S. Ct. 732, 735, 44 L. Ed. 882 (1900); *Union Nat'l Bank v. Louisville, N.A. & C. Ry.*, 163 U.S. 325, 331, 16 S. Ct. 1039, 1042, 41 L. Ed. 177 (1896); *Bartholomew v. Northampton Nat'l Bank*, 584 F.2d 1288, 1295 (3d Cir. 1978); *McAdoo v. Union Nat'l Bank*, 535 F.2d 1050, 1055-58 (8th Cir. 1976); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 861-64 (6th Cir. 1972)). Those cases, however, do not demonstrate that Congress intended to incorporate a state definition of interest that would authorize states unilaterally to incorporate non-percentage rate charges into an exportable definition under section 85. Moreover, none of those cases involve a definition of interest for exportation purposes where the definition varied between states.

*Nowlin, supra*, exemplifies the *Greenwood Trust* court's misplaced reliance on previous cases construing the NBA. In *Nowlin*, a national bank in Arkansas loaned money to the plaintiff, who agreed to repay the loan in installments. 509 F.2d at 874. Instead of amortizing the loan over the agreed term, the bank "discounted" the notes by 8%; that is, the bank gave the plaintiff the requested sum, but an additional 8% for every year of the notes' term

was immediately added to the outstanding principal amount. *Ibid.* The plaintiff then had to repay the adjusted principal amount in equal payments over the term. *Ibid.* Because all interest was calculated up-front based on the initial loan amount, instead of being calculated periodically on a declining principal balance, the national bank achieved an effective yield of nearly 16%. *Ibid.*

The bank did not dispute that Arkansas considered usurious interest rates over 10%. *Id.* at 876. Furthermore, the bank did not dispute that a state bank could not "discount" notes in a like manner because Arkansas case law defined interest for purposes of its usury laws as "effective yield." *Ibid.* However, the bank argued that because it was a national bank, it was subject only to section 85, which defined interest narrowly to include only percentage rates charged, not effective yields. *Ibid.* Because its 8% discount rate was less than the 10% Arkansas-usury rate, the bank argued that it did not violate the NBA. *Ibid.*

The court rejected the bank's arguments. After discussing the objectives of section 85, the court held that such a narrow interpretation would be inconsistent with Congress' desire to foster competitive equality between state and national banks. *Id.* at 880. Thus, the court held, Arkansas' definition of interest was incorporated into section 85. *Ibid.*

Contrary to the *Greenwood Trust* Court's conclusion, *Nowlin* does not offer an expanded definition of the term "rate," but rather shows only that calculation of chargeable interest rates must take "the case law of the state" into account. The state law regarding discounting was

given substantial weight because discounting, unlike late-fee charges, directly affects the numerical interest rate by altering the percentage rate over time. It is noteworthy that the *Nowlin* decision involved the intra-state, not inter-state, application of Arkansas' definition of interest. Thus, it said nothing about exporting that definition to a foreign state where state-usury laws are more restrictive. Moreover, the case should be read as a judicial attempt to protect state usury laws at the expense of the federal most-favored-lender doctrine.

Defendant also refers, as does the dissent, to *Smiley v. Citibank*, *supra*, 44 Cal. Rptr.2d 441 (1995), to support its position that "interest" under section 85 includes late charges. *Post* at \_\_\_ (slip op. at 4). Similar use is made of *Copeland v. MBNA America Bank, N.A.*, *supra*, \_\_\_ Colo. \_\_\_ (1995). The majority in *Smiley* bases that conclusion in large measure on its understanding of historical legal usage. *Smiley*, *supra*, at 449-51. See also *Copeland*, *supra*, at \_\_\_ (slip op. at 11-13) (same). In our view, however, interest in its historical setting is limited to a periodic charge expressed as a percentage of a principal balance due. See discussion, *supra*, at 25-28. The majority in *Smiley* also concluded that if interest does not include late charges then a state could discriminate against a national bank to make it unprofitable for it to lend money in that state. *Smiley*, *supra*, at 451. However, a state cannot discriminate against a national bank by permitting state banks to charge late fees or higher late fees while prohibiting a national bank from charging those fees. See discussion, *infra* at 38-41. See *Smiley*, *supra*, at 470 (George, J., dissenting) (noting that it has been established since the early 1800's that even in the absence of a specific federal

statutory prohibition a state may not discriminate against a federal instrumentality either in the enactment or enforcement of state laws). Thus, the most-favored-lender doctrine serves to eliminate discrimination without distorting or extending the meaning of interest to include charges that Congress neither expressly nor implicitly incorporated in the definition of interest.

### III

Defendant, as well as the dissent, cites a recently promulgated proposed interpretive ruling by the Office of the Comptroller of the Currency (OCC), the agency charged with enforcement of the NBA, as evidence that late fees constitute interest for purposes of the NBA. *Post* at \_\_\_ (slip op. at 16). The soundness of this ruling, and its value as authority, are greatly undermined when placed in the context of conflicting OCC rulings.

It is well settled that in general an agency's interpretation of a statute it is charged with enforcing is entitled to substantial deference, *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-45, 104 S. Ct. 2778, 2781-83, 81 L. Ed. 2d 694, 703-04 (1984); *EPA v. National Crushed Stone Ass'n*, 449 U.S. 64, 83, 101 S. Ct. 295, 307, 66 L. Ed. 2d 268, 283 (1980) (citing *Udall v. Tallman*, 380 U.S. 1, 16, 85 S. Ct. 792, 801, 13 L. Ed. 2d 616 (1965)), and must in general be upheld even if that interpretation is not the only permissible one or even the most reasonable. *Grocery Town Market, Inc. v. United States*, 848 F.2d 392, 396 (3d Cir. 1988). There are, however, exceptions to the general rule.

Far less than the usual amount of deference to an agency interpretation is appropriate when that agency has failed to adopt a consistent interpretation in administering the statute in question. *INS v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30, 107 S. Ct. 1207, 1221 n.30, 94 L. Ed. 2d 434, 457 n.30 (1987) (citing *Watt v. Alaska*, 451 U.S. 259, 273, 101 S. Ct. 1673, 1681, 68 L. Ed. 2d 80 (1981); *General Elec. Co. v. Gilbert*, 429 U.S. 125, 143, 97 S. Ct. 401, 411-12, 50 L. Ed. 2d 343 (1976)).

"It is emphatically the province and duty of the judicial department to say what the law is." *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177, 2 L. Ed. 60 (1803). Statutory construction is ultimately a judicial function. See, e.g., *SEC v. Sloan*, 436 U.S. 103, 118, 98 S. Ct. 1702, 1712, 56 L. Ed. 2d 148, 161 (1978); *Federal Maritime Comm. v. Seatrain Lines, Inc.*, 411 U.S. 726, 745-46, 93 S. Ct. 1773, 1784-85, 36 L. Ed. 2d 620, 633-34 (1973). Indeed, "one of the Judiciary's characteristic roles is to interpret statutes." *Japan Whaling Ass'n v. American Catacean Soc'y*, 478 U.S. 221, 230, 106 S. Ct. 2860, 2866, 92 L. Ed. 2d 166, 179 (1986). Accordingly, the Supreme Court in *Chevron, supra*, did not state that silence or ambiguity in a statute automatically requires a court to delegate its entire interpretive responsibility to an agency, especially when an agency's interpretation is contrary to the purpose of the statute or inconsistent. See *West v. Bowen*, 879 F.2d 1122, 1138 (3d Cir. 1989) (Mansmann, J., concurring and dissenting).

Courts have found consistency or lack thereof in an agency interpretation to be crucial in determining the degree of deference to be afforded that interpretation. See, e.g., *INS v. Cardoza-Fonseca, supra* (rejecting deference to

Board of Immigration Appeals due to years of inconsistent positions); *Director, Office of Workers' Compensation Programs v. Mangifest*, 826 F.2d 1318, 1319-20 (3d Cir. 1987) (finding "ambiguities and inconsistencies in the Director's interpretation of . . . regulations . . . sufficiently great to preclude deference"); *Revak v. National Mines Corp.*, 808 F.2d 996, 1002 (3d Cir. 1986) (rejecting deference arguments due to inconsistent agency interpretation of statute); *Disabled in Action v. Sykes*, 833 F.2d 1113, 1117-19 (3d Cir. 1987), *cert. denied*, 485 U.S. 989, 108 S. Ct. 1293, 99 L. Ed. 2d 503 (1988). There is a great difference between flexibility and vacillation. Accordingly, judicial deference to administrative rulings should be cast on a sliding scale whereby the usual respect for agency determination diminishes as apparent inconsistencies surmount. *West, supra*, 879 F.2d at 1134 (Mansmann, J., dissenting and concurring).

The federal administrative understanding of the meaning of "interest" has wavered. Cf. *Copeland, supra*, \_\_\_ Colo. at \_\_\_ (slip op. at 13) (asserting that "[t]he OCC consistently has taken the position that late payment fees are interest" under both section 85 of the NBA and section 521 of the DIDA) (emphasis added). An examination of OCC interpretive letters reveals significant inconsistent administrative treatment of interest with respect to the NBA. As early as 1964, the OCC, responding to an inquiry to define interest under the NBA, stated that "late payment fees . . . would not properly be characterized as interest." See Letter by James J. Saxon, Comptroller of the Currency (June 25, 1964), Brief of Petitioner-Defendant at Ex C. (No. 38,817). Then, in 1986, the OCC was asked specifically whether late fees were considered interest

that could be exported under section 85. Letter by Charles F. Byrd, Assistant Director, Legal Advisory Service (May 5, 1986), 1986 WL 143937 (O.C.C.). The agency opined that section 85 looks to state law to determine the maximum permissible interest rate, but that federal law determines which charges are "material" to the rate determination. *Id.* at \*1. Because courts had not determined whether late fees were material, the OCC refused to provide the answer. *Ibid.*

In 1988, however, the OCC issued Interpretive Letter No. 452, which addressed whether various fees charged by an out-of-state national bank to its credit cardholder in Iowa were material to the determination of the interest rate under Section 85. Letter by Robert B. Serino, Deputy Chief Counsel, Office of the Comptroller of Currency [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 at 78,063 (Aug. 11, 1988). The agency concluded that whether particular fees are material to the interest rate determination under section 85 depends on the laws of a national bank's home state. *Id.* at 78,065-66 (citing Interpretive Ruling 7.7310, 12 C.F.R. § 7.7310(a)).

The OCC recently has affirmed that position. See Letter by Peter Liebsman, Assistant Director, Bank Operations and Asset Division (February 26, 1993), 1993 WL 501557 at \*2 (the "1993 OCC Letter"). However, because the State failed to define "materiality", the 1993 OCC Letter stated that "characteristics of either the loan or the borrower . . . [that are] an integral part of a bank's decision to establish the rate of interest that will be charged" typically are material. *Id.* at \*3. Notably, the OCC opined that charges such as "late fees, nonsufficient check charges, cash advance fees and attorney fees

appear not to determine the numerical rate of interest to be charged." *Id.* at \*4. Because such fees have only an "indirect effect on interest rates in that they may affect the ultimate return on loan proceeds," the agency suggested that absent their inclusion in the home-state's definition of interest, they would not be material, and thus, would not be exportable. *See Ibid.*

The conflicting interpretations, coupled with the logic expressed in the "materiality" standard, convince us that this Court should not forsake its own considered reasoning by relying on an equivocation. It is the responsibility of Congress to depart from the traditional understanding of interest and to express an intent to include non-numerical interest rates in its definition of "interest" under the NBA.

#### IV

New Jersey's banking statutes also reflect the basic understanding that the notion of interest was conceived and continues to be defined as specific percentage rates, rather than discrete charges, such as late fees, which are not directly related to borrowing money. N.J.S.A. 17:13A, which governs installment loan rate advertising, defines interest as follows:

every charge paid to the lender or contracted for by the lender and the borrower in connection with or as an incident of a loan, whether designated as interest or as a financial charge or otherwise, *except that the term does not include the following charges when made pursuant to law: late or delinquency charges; attorneys' and collection fees; insurance premiums, including premiums*

for credit life insurance; recording or filing fees, and all other charges which may lawfully be made on loans in addition to interest or finance charges.

[N.J.S.A. 17:13A-2(g) (emphasis added).]

Other statutes distinguish late fees from interest by either authorizing or prohibiting certain lending institutions from making such charges. N.J.S.A. 17:13-104b specifically authorizes New Jersey credit unions to charge late fees to its members.

Notwithstanding the provisions of R.S. 31:1-1 to the contrary, a credit union may charge, contract for, and receive interest on loans at a rate or rates agreed to by the credit union and the member. A credit union may charge late fees and lawful fees paid to any public officer for filing, recording, or releasing a document, and may charge collection fees, not to exceed 20% of the principle [sic] balance and interest outstanding, which may be added to the principal balance of any loan placed for collection after default thereon.

[N.J.S.A. 17:13-104b (emphasis added).]

N.J.S.A. 17:9A governs a banking institution's authority to make check loans and other loans, N.J.S.A. 17:9A-59.1 to -59.17, small business loans, N.J.S.A. 17:9A-59.25 to -59.39 and loans secured by a deposit, N.J.S.A. 17:9A-59.40-63. In defining the amount of interest permitted on each class of loans, the respective statutes specifically include only percentage rate interest, not other financial charges. Other charges are provided for in separate sections. For example, N.J.S.A. 17:9A-59.6, sets the

rate of interest for advance loans. Later provisions provide for additional fees on advance loans, such as late charges, N.J.S.A. 17:9A-59.7, and service charges, N.J.S.A. 17:9A-59.8.

On the other hand, New Jersey's RISA prohibits lenders from charging late fees and other financial charges in addition to interest. The statute provides:

No retail seller, sales finance company, or holder shall charge, . . . directly or indirectly, any further or other amount for costs, charges, insurance premiums, examination, appraisal service, brokerage, commission, expense, interest, discount, fees, fines, penalties or other things of value in connection with . . . retail charge accounts other than the charges permitted by this act. . . .

[N.J.S.A. 17:16C.50.]

At the time this case was before the Court, the statute expressly authorized delinquency or late-payment charges on only retail installment contracts. N.J.S.A. 17:16C-42(a). On March 7, 1995, however, the statute was amended by L. 1995, c. 43, § 1, which specifically allows for late-payment charges on retail charge accounts. It provides in pertinent part that:

The holder of any retail charge account may collect a delinquency or collection charge in an amount not to exceed \$10 if provided for in the retail charge account agreement, on any minimum payment which has not been paid in full

for a period of 10 days after its due date, as originally scheduled.

[L. 1995, c. 43, § 1.]

The effective date of the amendment was May 29, 1995, 90 days following its enactment. L. 1995, c. 43, § 2. Thus, for purposes of this appeal, defendant's late-fee charges were still illegal under RISA. This amendment to the statute indicates, however, that the legislature did not intend to include late-fee charges within its definition of interest; rather, it expressly specified when and under what conditions other non-percentage rate charges could be procured by lenders in addition to annual interest rate charges.

Moreover, the regulations governing banking specifically provide for the maximum *rate* of interest to be charged on the issuance of different types of loans. N.J.A.C. 3:1-1.1; N.J.A.C. 3:1-1.2. These regulations governing interest say nothing about other financial charges, such as late fees. Thus, the manner in which both the Legislature and the Department of Banking have chosen to regulate lender-authorized charges clearly supports the conclusion that late fees are distinct from interest and thus not contained within the accepted definition of interest. The dissent incorporates late fees, and presumably other similar charges, into the notion of traditional interest by homogenizing what the Legislature has meticulously separated. It does so only by obscuring the clear language and structure of the legislative treatment of interest and late fees. See *Post* at \_\_\_ (slip op. at 24-28).

The State Bank Parity Act, N.J.S.A. 17:13B-1 to -2, authorizes New Jersey banks to charge the same "rate of

interest" charged by credit unions. N.J.S.A. 17:13B-2 provides:

Notwithstanding any provisions of R.S. 31:1-1 or any other statute to the contrary, any bank, savings bank, savings and loan association or credit union may charge a *rate* of interest on any class or type of loan at the rate of interest permitted to any other lender by the laws of this State on that class or type of loan.

[N.J.S.A. 17:13B-2 (emphasis added).]

The Assembly Banking and Insurance Committee Statement that accompanied this legislation indicates that the act was intended as a state-bank companion to section 85 of the NBA.

This legislation would give state chartered banks, savings banks, savings and loan associations, and credit unions the same "most-favored-lender" authority that national banks presently enjoy. . . . In practice, a national bank may charge interest on any type of loan at the highest rate allowed to any lender in the state making any similar type of loan. Thus, in certain cases, national banks may now use the rate permitted to be charged by secondary mortgage loan licensees, small loan companies (this rate will now apply to bank credit cards because of legislation passed last year), or home repair contractors. This legislation, therefore, provides parity to state-chartered institutions.

[Assembly Banking & Insurance  
Committee, *Statement to Assembly*  
*Bill No. 1986 (1981).*]

Thus, while the Act provides for parity between the rates of interest charged by both banks and credit unions, the act does not explicitly authorize banks to charge other types of fees. Furthermore, there is no indication that the Legislature implicitly intended these other fees in the State Bank Parity Act. Indeed, the fact that the Legislature has passed separate statutes that expressly authorize the imposition of discrete fees and charges, (see discussion, *supra*, at \_\_\_ (slip op. at 24-28)), in contrast to interest, underscores the understanding that those types of charges are not contemplated by the State Bank Parity Act. The clearest indication of the Legislature's intent to distinguish between interest rates and late fees is in the language of its recent amendment to RISA, in which it expressly authorizes holders of retail charge accounts, as well as retail installment contracts, to charge late fees. The Legislature obviously enacted this law because it wanted to enable banks and other retail charge-account holders to charge late fees that credit unions were permitted to charge under N.J.S.A. 17:13-104b. Had the State Bank Parity Act provided parity between lenders as to specific non-interest rate charges, there would have been no need for the amendment because holders of retail charge accounts would have been entitled, pursuant to the parity act, to charge the late fees that credit unions were authorized to charge. Courts should avoid a construction that would render legislative enactments meaningless. *State v. Reynolds*, 124 N.J. 559 (1991). Thus, by excluding discrete charges from the parity act, the Legislature retained flexibility with respect to the non-percentage rate fees different lenders were permitted to charge their customers. For example, retail charge account

holders are limited to a \$10 late-fee per default period, while credit unions have no such limitation.

The language of RISA itself indicates the legislative intent to leave room for subsequent legislative initiatives to allow different lenders to make discrete non-percentage rate charges; it states that a retail seller, sales finance company or holder cannot charge additional fees or charges "other than the charges permitted by this act." Thus, the Legislature, in reserving within the statute the ability to authorize certain charges, has correctly recognized that there may be specific reasons for treating different lenders differently. For example, there may be specific reasons for allowing a credit union, rather than a bank, to charge late fees. Credit unions are small, individualized lenders which do not cater to a large market. Furthermore, credit unions have a genuine social welfare purpose. In assisting their members they cannot spread costs like banks. Thus, they must be permitted to take actions, such as charging late fees, to help insure their solvency.

The dissent points to a letter from the Department of Banking to support its theory that the State Bank Parity Act includes late fees in its definition of interest. *Post*, at \_\_\_ (slip op. at 27-28) (citing Letter from Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994)). Relying on an informal and isolated expression of agency interpretation has limited authoritative weight and does little to buttress its argument. Here, we are not presented with duly promulgated regulations that express legislative intent. *Metromedia, Inc. v. Director, Div. of Taxation*, 97 N.J. 313, 331 (1984) (emphasizing that procedural requirements for passage of rules, involving

notice and public participation, are given authoritative weight). Nor are we confronted with even a course of regulatory conduct that reflects a clear and consistent administrative understanding as evidence of an underlying legislative intent. *Body-Rite Repair Co., Inc. v. Director, Div. of Taxation*, 89 N.J. 540, 545-46 (1982) (holding that practical administrative construction of statute over period of years without interference by Legislature is evidence of conformity with legislative intent and should be given great weight by court). Clearly, a single letter from the Department of Banking does not constitute a settled or widespread course of administrative conduct that can be equated with the interpretive authority of a duly promulgated rule. Moreover, it cannot provide a meaning that is neither expressed in the statute, nor in the legislative scheme governing banking. Our deference does not go so far as to permit an administrative agency under the guise of an administrative interpretation to give a statute any greater effect than is permitted by statutory language. *In re Adoption of N.J.A.C. 7:26B*, 128 N.J. 442, 450 (1992) (citation omitted).

This Court has found no legislative authority to support the contention that interest in the context of either the State Bank Parity Act or the NBA encompasses a variety of lender-imposed fees and financial requirements that are independent of a numerical percentage rate. Thus, we can conclude only that neither Congress, in passing the NBA, nor the New Jersey Legislature, through its own parity act, intended to include late fees in its definition of interest for the purpose of preventing discrimination against out-of-state lenders.

## V

Defendant argues that although the new RISA amendment is inapplicable to the charges assessed in this case, the fact that New Jersey credit unions were permitted to charge late fees at the time defendant procured those fees, pursuant to the most-favored-lender doctrine, entitled out-of-state national banks, like defendant, to charge late fees. We disagree.

Although a national bank may "borrow" the interest rate from any lending institution in its home state, without regard to whether that institution is actually "competitive" with a national bank, a national bank is not authorized to charge late fees simply because a state credit union is so authorized in a state other than its home state. Inter-state parity, as established in *Marquette*, is commonly identified as the notion that a national bank is entitled to export the interest authorized by its home state to borrowers located in other states that authorize a lower interest rates [sic]. *Marquette, supra*, 439 U.S. at 313-14, 99 S. Ct. at 548, 58 L. Ed. 2d at 545. The defendant seeks to extend this inter-state parity notion by arguing that a foreign national bank lending to customers in New Jersey is entitled to charge the interest authorized by the state in which the bank is located or the interest authorized in New Jersey, whichever is higher, and that for purposes of determining what interest can be exported, all of the extra charges authorized by the borrower's state can be included as well. Thus, it argues a foreign national bank can charge late fees because New Jersey credit unions are permitted to charge them and, under the most-favored-lender doctrine, national banks can charge the same interest – in its most expansive form – as any state lender. The

argument, we find, overreaches the federal statutory scheme.

Section 85 of the NBA provides in pertinent part:

Any [national bank] association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, *interest at a rate allowed by the laws of the State, Territory, or District where the bank is located*, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except where by the laws of any State a different rate is limited for banks organized under state laws, *the rate so limited shall be allowed for associations organized or existing in any such state under this chapter.*

[12 U.S.C.A. § 85 (emphasis added).]

Section 86 reads in pertinent part:

The taking, receiving, reserving or charging a rate of interest greater than is allowed by section 85 of this title, when knowingly done, shall be deemed a forfeiture of the entire interest . . . In case the greater rate of interest has been paid, the person by whom it has been paid, . . . may recover back, . . . twice the amount of the interest thus paid. . . .

[12 U.S.C.A. § 86.]

For purposes of section 85, a national bank is located either in the place designated in its organizational certificate or in the places in which it has established authorized branches. *Marquette, supra*, 439 U.S. at 309 n.21, 99

S. Ct. at 546 n.21, 58 L. Ed. 2d at 542-43 n.21. A plain reading of the statute and most cases interpreting it indicate that a national bank is permitted to charge the interest rate of the state in which it is located, *not* the interest rate of the state in which the out-of-state customer is located. *Id.* at 301, 99 S. Ct. at 542, 58 L. Ed. 2d at 537-38 (ruling that section 85 authorizes a national bank based in one state to charge its out-of-state credit card customers an interest rate on unpaid balances allowed by its home state, when that rate is greater than that permitted by the state of the bank's nonresident customers); *Cades v. H & R Block, Inc.*, 43 F.3d 869, 874 (4th Cir. 1994) (determining that Delaware law applied to fix the interest rate when the bank located in Delaware, even though the loan occurred in South Carolina; "section 85, which looks to the interest rates allowed by the state where the bank is located - not where the borrower is located or where the loan transaction may be said to have occurred").

Moreover, there is some indication that it is illegal for a national bank to charge interest in excess of that amount permitted in its home state. In *Panos v. Smith*, *supra*, 116 F.2d 446, the court read sections 85 and 86 together to find that the NBA forbids a national bank to collect a higher rate of interest than is permitted by the law of the state in which it is located. Although none of these cases specifically dealt with a situation where the interest in the state of the customer was higher or more permissive than the national bank's home state, the basic understanding that resort to the higher level of interest would not be allowed is readily inferable from their treatment of the subject.

The theory of the NBA, as applied by federal and state courts, is that the borrower's state usury laws can be discarded because the customer either taking out a loan or using her "lender credit card" partakes in a transaction in the national lender's home state. *See Marquette, supra*, 439 U.S. at 318-19, 99 S. Ct. at 550, 58 L. Ed. 2d at 548 (recognizing that impairment of state usury laws "has always been implicit in the structure of the National Bank Act, since citizens of one state were free to visit a neighboring state to receive credit at foreign interest rates"); *Schumacher v. Lawrence, supra*, 108 F.2d 576, 577 (6th Cir. 1940) (stating that the question whether the rate of interest charged by a national bank is usurious is decided according to the law of the state in which the transaction occurs); *Haas v. Pittsburgh Nat'l Bank*, 60 F.R.D. 604, 608 n. 3 (W.D.Pa. 1973) (same); *Fisher v. First Nat'l Bank, supra*, 548 F.2d at 257 ("A[n] [Iowa] customer using this "lender credit card" . . . communicates or indicates his intention to establish the credit card arrangement with BankAmericard when the lender, through banking channels, receives in the State of Nebraska the draft of the customer."). It is clear that Congress intended that the NBA and DIDA immunize national banks and out-of-state federally insured banks that lend money beyond their home-state's borders from local usury laws that might give local banks a competitive advantage. *E.g., Tiffany, supra*, 85 U.S. at 412-13, 21 L. Ed. at 863-64 (holding that Congress, by enacting NBA, intended to protect national banks from hostile state usury laws); *Sherman*, 272 N.J. Super. at 440 (same); *Hunter*, 272 N.J. Super. at 530 (same); 12 U.S.C.A. 1831d(a) (permitting State-chartered insured depository institutions to charge interest rates permitted in their

home state "[i]n order to prevent discrimination against State-chartered insured depository institutions"). Thus, the statutes were intended to prohibit states from forcing national banks to charge a lower rate of interest to customers located outside of the national bank's home state than they would be permitted to charge their customers located in the home state.

We do not believe prohibiting national lenders from charging the rate of interest permitted by the laws of a foreign state would be considered discrimination when the national bank was not organized in that state and would not be able to charge higher interest rates except by taking advantage of the laws of the foreign state. New Jersey's RISA does not conflict with the most-favored-lender doctrine in this case, and thus New Jersey should be permitted to prohibit out-of-state lenders from charging late-fees to New Jersey residents, because, at the outset of this case, New Jersey banks were also prohibited from charging those fees. This finding would enable state usury laws to remain vital and controlling over non-interest rate credit terms. Consumer credit protection is a fundamental local interest, long recognized by Congress, and it thus should not be displaced by the sweeping preemption urged by defendant.

Because at the time of this appeal, RISA prohibited both New Jersey and national retail charge account holders from charging late fees, we hold that defendant's late-fee charges violated this state's usury laws and are thus impermissible.

## VI

Although the late-fee charges at issue in this case are impermissible under the RISA statute as it existed when those fees were assessed, we acknowledge, as suggested by the parties, that such charges assessed after May 29, 1995 do not appear to be illegal under that statute. As earlier discussed, *supra* at \_\_\_ (slip op. at 28.29), the Legislature amended the statute to permit "the holder of any retail charge account [to] collect a delinquency or collection charge" of no more than \$10. L. 1995, c. 43, § 1. Pursuant to the statute, a "holder" is "any person, including a retail seller, who is entitled to the rights of a seller under a retail installment contract or retail charge account." N.J.S.A. 17:16C-1(m). A "retail charge account" is

any account . . . established by agreement which prescribes the terms under which a retail buyer may from time to time purchase or lease goods or services which are primarily for personal, family or household purposes, and under which the unpaid balance thereunder, whenever incurred is payable in one or more installments and under which a time price differential may be added in each billing period as provided herein. Retail charge account also includes all accounts arising out of the utilization by the holder of a credit card . . . issued by a sales finance company, giving the holder the privilege of using the credit card . . . to become a retail buyer in transactions out of which debt arises.

[N.J.S.A. 17:16C-1(r).]

Although the statute does not expressly include banks within these definitions, clearly banks have for years

been performing the functions attributable to holders of retail charge accounts. See N.J.S.A. 17:3B-4 to -28 (Market Rate Consumer Loan Act) (authorizing New Jersey banks to offer revolving credit plans at an interest rate agreed to by lender and borrower); N.J.S.A. 17:9A-59.1 (permitting advance loans by banks). In fact, the statute expressly provides that "any banking institutions authorized to do business in this State, shall be authorized to transact business as a sales finance company." N.J.S.A. 17:16C-2. Thus, it appears that the Legislature intended to include banks that issue credit cards within those institutions authorized to assess late charges on overdue charge accounts. Therefore, a bank may contract to charge the delinquency fee on the same basis as any other "holder of any retail charge account" in New Jersey.

Nothing in the statute indicates a legislative intention to allow state banks to charge delinquency fees while prohibiting national banks and federally-insured state banks from assessing those fees. In fact, the statute defines banking institutions generally as "any bank, national banking association, savings bank or federally chartered savings bank authorized to do business in this State". N.J.S.A. 17:16C-1(n). There is no distinction between a national banking association and an association under state laws except where the distinction is specifically made by Congress. *Anderson v. First Nat'l Bank*, 54 F. Supp. 937 (D.Idaho 1944). States may not discriminate against national banks with respect to general contract terms or charges. See *Anderson Nat'l Bank v. Lueckett*, 321 U.S. 233 (1944) (national banks are subject to state laws unless those laws infringe upon national banking laws or impose undue burden on performance of

bank's functions); *National State Bank v. Long*, 630 F.2d 981, 985 (3d Cir. 1980). Thus, national banks, as well as federally-insured state banks, are permitted to charge the late fees authorized by statute to the same extent as state banks.

However, New Jersey retains the authority to regulate on a non-discriminatory basis all non-interest rate contractual terms and conditions of a bank as a holder of a retail charge account. The Supreme Court has held that state law controls a bank's right to collect its debts.

[National banks] are governed in their daily course of business far more by the laws of the State than of a nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.

[*National Bank v. Commonwealth*, 6 U.S. (9 Wall) 353, 362, 19 L. Ed. 70 (1870).]

Thus, it would appear that a national bank and a federally-insured state bank may, as of May 29, 1995, charge a delinquency fee in accordance with the authorization now given by the statute. See L. 1995, c. 43.

## VII

The judgment of the Appellate Division is reversed.

Chief Justice Wilentz and Justices Stein and Coleman join in Justice Handler's opinion. Justice Pollock has filed

a separate dissenting opinion in which Justice Garibaldi joins. Justice O'Hern has also filed a separate dissenting opinion.

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SUPREME COURT OF NEW JERSEY  
A-102 September Term 1994

MARC SHERMAN, on behalf of himself  
and all others similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA), N.A.,

Defendant-Respondent.

POLLOCK, J., dissenting.

This appeal poses the question whether a national bank located in South Dakota may impose a late charge on a credit-card customer who resides in New Jersey, if South Dakota permits the charge, but New Jersey does not. More specifically, the appeal focuses on whether the definition of "interest" in the National Bank Act (NBA), 12 U.S.C.A. § 85 (section 85), includes late charges, and, if so, whether that statute preempts the New Jersey Retail Installment Sales Act of 1960, N.J.S.A. 17:16C-1 to -94 (RISA).

In a class-action complaint brought on behalf of himself and other Citibank credit cardholders, petitioner, Marc Sherman, asserts that the RISA precludes defendant, Citibank (South Dakota), N.A. (Citibank), a national banking association located in South Dakota, from imposing late charges on cardholders located in New Jersey. The Law Division granted Citibank's motion to dismiss the complaint with prejudice. The Appellate Division affirmed. 272 N.J. Super. 435. The majority reverses. I dissent.

## -I-

Because the appeal arises from the grant of Citibank's motion to dismiss, I accept as true all facts alleged in the complaint. See *Bozza v. Vornado, Inc.*, 42 N.J. 355, 357-58 (1964). Sherman alleges that in 1989 Citibank sent to him at his New Jersey residence an application, Visa card, and Card Member Agreement. The record, however, does not include copies of these instruments. According to the complaint, the annual percentage-rate finance charge (periodic interest) is 19.8 percent. In addition, a cardholder who does not make the minimum payment within twenty-five days of the due date is subject to a fixed late-payment fee regardless of the amount of the outstanding balance or delinquent payment. Twice Sherman was late in making his monthly payment. Each time, Citibank imposed a late charge.

Sherman claims that the late charges violate various provisions of New Jersey's Consumer Fraud Act, N.J.S.A. 56:8-2 and -19, and of the RISA, N.J.S.A. 17:16C-50 and -54. The Fraud Act prohibits undisclosed late charges, and the RISA prohibits delinquency charges on revolving credit accounts. He also claims that the late fees constitute a common-law breach of contract and conversion. All claims depend on whether Citibank may impose late charges as interest.

The initial task is to determine the meaning of "interest" in section 85. That section permits national banks to charge borrowers "interest at the rate allowed by the laws of the State . . . where the bank is located." 12 U.S.C.A. § 85. South Dakota, the state where Citibank is located, defines "interest" to include late charges: "Interest is the

compensation allowed by law for the use, or forbearance, or detention of money or its equivalent, including without limitation . . . charges for unanticipated late payments, and any other charges, direct or indirect, as an incident to or as a condition of the extension of credit." S.D. Codified Laws Ann. § 54-3-1 (1995). Citibank claims that as a South Dakota bank it may impose late charges on defaulting customers whether those customers are located in South Dakota, New Jersey, or anywhere else.

Sherman, however, relies on the RISA, which permits credit-card issuers to charge periodic interest, but not late fees: "No retail seller, sales finance company, or holder shall charge, . . . directly or indirectly, any further or other amount for costs, charges, insurance premiums, examination, appraisal service, brokerage, commission, expense, interest, discount, fees, fines, penalties or other things of value in connection with . . . retail charge accounts. . . ." N.J.S.A. 17:16C-50. He claims that "interest" in section 85 refers to periodic interest, but not to late charges. Consequently, he denies that the RISA conflicts with the NBA.

## -II-

Initially dividing the majority and the dissent is the meaning of the word "interest" as used in the NBA. Both agree that "interest" includes periodic interest, the amount paid for the use of money calculated as a percentage of the sum due for a stated period, typically one year. That definition, however, is not exhaustive. The meaning of the word becomes indeterminate at the margins. Webster's Dictionary, for example, accords "interest" seven

definitions, six with subparts. Definition 3(a) defines "interest" as "the price paid for borrowing money generally expressed as a percentage of the amount borrowed paid in one year. . . ." *Webster's Third New International Dictionary* (1976). The use of the adverb "generally" suggests the existence of other definitions. So construed, accepted usage recognizes that "interest" may include charges other than periodic interest. Consistent with that construction, the Supreme Court of California recently concluded that dictionary definitions of "interest" "then current in American legal usage" at the time of the passage of the NBA are broad enough to include late charges. *Smiley v. Citibank (South Dakota) N.A.*, 44 Cal. Rptr. 2d 441, 450-51 (1995).

More relevant than the meaning that lexicographers assign to statutory terms is the meaning assigned by the Legislature. To bridge the gap between dictionary definitions and legislative intent, the California Supreme Court apparently assumed that Congress consulted the dictionaries cited in *Smiley*. Dictionaries, however, are not essential to the judicial search for the meaning of statutory terms. *Cabnell v. Markham*, 148 F.2d 737, 739 (2d Cir. 1945). To illustrate, when deciding that "interest" in the NBA includes late charges, the Colorado Supreme Court recently concluded "that the common dictionary definitions are not sufficiently precise to settle the question before us." *Copeland v. MBNA America, N.A.*, \_\_\_ Colo. \_\_\_ (1995) (slip op. at 9).

Absent an express statutory definition, courts may glean the meaning of legislative language from sources such as statutory history, purpose, and structure. In ascertaining the meaning of a statutory term, a court's

task is not to create its own definition, but to ascertain the definition intended by the Legislature. E.g., *Norfolk & Western Ry. Co. v. American Train Dispatchers Ass'n*, 499 U.S. 117, 128, 111 S. Ct. 1156, 1163, 113 L. Ed. 2d 95, 106-07 (1991); *Roig v. Kelsey*, 135 N.J. 500, 515 (1994). The NBA does not expressly define "interest." Nor does a fair reading of the legislative history of the statute disclose the intended meaning of that term. Accordingly, I search elsewhere for the word's meaning in the NBA.

The early history of national banking sheds some light on congressional intent in the NBA. Before enacting the NBA, Congress twice had tried unsuccessfully to create a Bank of the United States. Each time, however, states'-rights advocates defeated attempts to renew the Bank's charter. See John J. Knox, *A History of Banking in the United States* 35-48, 51-71 (1900) (discussing creation and dissolution of Bank of the United States and Second Bank of the United States); Bray Hammond, *Banks and Politics in America* 197-226, 369-450 (1957) (same). Then, in 1864, responding to the economic turmoil created by the Civil War, Congress adopted the NBA. Among other things, the NBA re-established a system of national banks. See Knox, *supra*, at 91-111 (discussing NBA); Hammond, *supra*, at 718-34 (same). To overcome local prejudice in favor of state banks, Congress included section 85. By mandating interest-rate parity in section 85, Congress sought to provide a level playing field for national banks throughout the United States. See Knox, *supra*, at 235-69. Although helpful, the history of the NBA is not dispositive of the meaning of interest in the NBA. *Copeland, supra*, \_\_\_ Colo. at \_\_\_ (slip op. at 10).

The United States Supreme Court first construed section 85 in *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 21 L. Ed. 862 (1873). The plaintiff, Tiffany, challenged the legality of the ten-percent interest rate charged to Missouri borrowers by the defendant, National Bank of Missouri. Missouri's usury laws limited to eight percent the interest rate that state-chartered banks could charge, but allowed non-bank lenders to charge interest at a rate of ten percent. *Id.* at 411, 21 L. Ed. at 863. Reasoning that section 85 permitted the defendant national bank to charge interest at a "rate allowed by the laws of [Missouri]", the Court held that the bank could charge the highest interest rate that could be charged by any lender in that state. *Id.* at 411-13, 21 L. Ed. at 863-64. In so holding, the Court required states to treat national banks as a "most favored lender." *Id.* at 413, 21 L. Ed. at 864. Although the Court acknowledged that its holding might disadvantage state-chartered banks, it relied on the overriding congressional intent to create a strong national banking system immune from unfriendly state legislation. *Id.* at 412-13, 21 L. Ed. at 863-64. "National banks," the Court declared, are "national favorites." *Id.* at 413, 21 L. Ed. at 864.

Over a century later, the Court revisited section 85 in *Marquette National Bank v. First of Omaha Service Corp.*, 439 U.S. 299, 99 S. Ct. 540, 58 L. Ed. 2d 534 (1978). The plaintiff, Marquette National Bank of Minnesota (Marquette), challenged the interest rate charged by a Nebraska national bank to Minnesota credit cardholders. Minnesota law prohibited banks in that state from charging more than twelve percent on credit-card balances, but allowed them to charge an annual fee up to \$15. *Id.* at

302-03, 99 S. Ct. at 542-43, 58 L. Ed. 2d at 538. Nebraska law, however, allowed banks to charge up to eighteen percent on outstanding credit-card balances below \$1,000. *Id.* at 302, 99 S. Ct. at 542, 58 L. Ed. 2d at 538. First National Bank of Omaha (Omaha Bank), a national bank chartered in Nebraska, charged eighteen percent interest on outstanding balances of Minnesota credit cardholders. *See id.* at 304, 99 S. Ct. at 543, 58 L. Ed. 2d at 539. Marquette claimed it was losing customers to Omaha Bank because "Marquette was forced by the low rate of interest permissible under Minnesota law to charge a \$10 annual fee for the use of its credit cards." *Ibid.*

The Court determined that although the cardholders lived and made credit-card purchases in Minnesota, Omaha Bank was "located" in Nebraska. *Id.* at 310-13, 99 S. Ct. at 546-48, 58 L. Ed. 2d at 543-45. Consequently, Omaha Bank could charge the favorable Nebraska rate to its customers in Minnesota. *Id.* at 313-14, 99 S. Ct. at 548, 58 L. Ed. 2d at 545. As in *Tiffany*, *supra*, 85 U.S. at 412-13, 21 L. Ed. at 863-64, the Court noted the clear congressional intent to favor national banks, even at the expense of state banks. *Marquette Nat'l Bank*, *supra*, 439 U.S. at 314-18, 99 S. Ct. at 548-50, 58 L. Ed. 2d at 545-48.

Although *Tiffany* and *Marquette* discussed permissible rates of interest under section 85, they did not define "interest." Recent federal decisions, however, illuminate the meaning of interest in section 85. *See Greenwood Trust Co. v. Massachusetts*, 971 F. 2d 818 (1st Cir. 1992), *cert. denied*, \_\_\_ U.S. \_\_\_, 113 S. Ct. 974, 122 L. Ed. 2d 129 (1993); *Tikkanen v. Citibank (South Dakota), N.A.*, 801 F. Supp. 270 (D. Minn. 1992).

*Greenwood Trust* involved a federally-insured state bank chartered in Delaware that issued credit cards throughout the United States, including Massachusetts. 971 F. 2d at 821. The bank, Greenwood Trust Company, imposed late charges on its delinquent credit-card customers. Delaware law, like South Dakota law, characterizes late charges as "interest." *Id.* at 829. The state claimed that Massachusetts' consumer-protection law, like the RISA, prohibited late charges. *Id.* at 821. Greenwood Trust argued, however, that by reference to the law of Delaware, the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA) authorized it to charge late fees as interest.

Section 521 of the DIDA grants the same protection to federally-insured state banks that section 85 of the NBA provides to national banks. Section 521 provides that any federally-insured state bank may,

notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank . . . is located or at the rate allowed by the laws of the State . . . where the bank is located, whichever may be the greater. . . .

[12 U.S.C.A. § 1831d(a).]

The United States Court of Appeals for the First Circuit ruled that under section 521 *Greenwood Trust*

could charge its Massachusetts cardholders the highest interest rate allowed by Delaware law. *Greenwood Trust, supra*, 971 F. 2d at 827. The court determined that both Delaware's express statutory provision, *Del. Code Ann.* tit. 5, § 950 (1994), and federal common law support a broad definition of "interest" that includes late fees. 971 F. 2d at 829-30 (citing *American Timber & Trading Co. v. First Nat'l Bank*, 690 F. 2d 781, 787-88 (9th Cir. 1982) (compensating balance requirement); *Fisher v. First Nat'l Bank*, 548 F. 2d 255, 258-61 (8th Cir. 1977) (cash-advance fee); *Panos v. Smith*, 116 F. 2d 445, 446-47 (6th Cir. 1940) (mortgage, taxes, and recording fees); *Cronkleton v. Hall*, 66 F. 2d 384, 387 (8th Cir.) (bonus or commission), *cert. denied*, 290 U.S. 685, 54 S. Ct. 121, 78 L. Ed. 590 (1933); *Nelson v. Citibank (South Dakota) N.A.*, 794 F. Supp. 312, 318 (D. Minn. 1992) (late fees)). Thus, the court concluded that for purposes of section 521, "interest" includes late fees, and that *Greenwood Trust* could "export" those charges authorized by Delaware law to Massachusetts. *Greenwood Trust, supra*, 971 F. 2d at 831.

The vast majority of state and federal courts have followed *Greenwood Trust*. E.g., *Ament v. PNC Nat'l Bank*, 849 F. Supp. 1015 (W.D. Pa. 1994); *Watson v. First Union Nat'l Bank*, 837 F. Supp. 146 (D.S.C. 1993); *Goehl v. Mellon Bank*, 825 F. Supp. 1239 (E.D. Pa. 1993); *Smiley, supra*, 44 Cal. Rptr. 2d at 453; *Stoorman v. Greenwood Trust Co.*, 888 P. 2d 289 (Colo. Ct. App.), *rehearing denied*, \_\_\_ Colo. Ct. App. \_\_\_ (1994), *cert. granted*, \_\_\_ Colo. \_\_\_ (1995); *Copeland, supra*, \_\_\_ Colo. \_\_\_; *Sherman, supra*, 272 N.J. Super. 435; *Hunter v. Greenwood Trust Co.*, 272 N.J. Super. 526 (App. Div. 1994).

*Tikkanen, supra*, 801 F. Supp. 270, reached the same conclusion under section 85 as *Greenwood Trust* had reached under section 521. In *Tikkanen*, which is virtually identical to this appeal, the plaintiff argued that section 85's definition of interest was restricted to numerical periodic interest rates and did not include late-payment charges authorized by South Dakota, the defendant national bank's home state. 801 F. Supp. at 277. The federal district court held, however, that interest under section 85 was not limited to percentage-rate charges and could include fixed late fees. *Id.* at 276-78. Although the court did not announce a federal definition of interest that included late fees, it held that if a national bank's home state defines interest to include such fees, then the bank may "export" those fees under section 85. *Id.* at 279.

Rejecting the *Greenwood Trust* and *Tikkanen* line of cases, lower courts in Pennsylvania have held that "interest" does not include late-payment fees. *Mazaika v. Bank One, Columbus, N.A.*, 653 A. 2d 640 (Pa. Super. 1994), appeal granted, 659 A.2d 557 (Pa. 1995); *Gadon v. Chase Manhattan Bank*, 653 A. 2d 697 (Pa. Super. 1995) (following *Mazaika*). One United States District Court has reached a similar conclusion. *Copeland v. MBNA America, N.A.*, 820 F. Supp. 537 (D. Colo. 1993) (denying federal jurisdiction based on complete preemption defense because "ordinary meaning" of interest does not encompass late fees).

In *Mazaika, supra*, 653 A. 2d at 646, a Pennsylvania intermediate appellate court stated that "[i]t would appear beyond peradventure that the plain and ordinary meaning of the term 'interest' or 'interest rate' does not include late fees, . . . or the like which are not levied on a percentage basis." I find, however, that the meaning of

"interest" and "rate of interest" are not as plain as the *Mazaika* court found them. As the OCC has concluded, *infra* at 16-17, interest could include all charges for the "use or forbearance of money," including late fees. See *Brown v. Hiatts*, 82 U.S. (15 Wall.) 177, 185, 21 L. Ed. 128, 131 (1872).

### -III-

The modern history of banking has been one of expanding regulation. Banks are subject to regulation by multiple federal agencies. The Comptroller of the Currency, 12 U.S.C.A. § 1; the Federal Housing Finance Board, 12 U.S.C.A. § 422a; the National Credit Union Administration, 12 U.S.C.A. § 1752a; the Federal Deposit Insurance Company, 12 U.S.C.A. § 1811; the Office of Thrift Supervision, 12 U.S.C.A. § 1462a; and the Board of Governors of the Federal Reserve System, 12 U.S.C.A. § 248, all regulate various aspects of banking. In addition, banks often are subject to dual regulation by state banking authorities.

With banking, as with other heavily-regulated commercial activities, Congress has recognized that it cannot maintain an efficient regulatory system through constant recourse to the legislative process. See Kenneth C. Davis & Richard J. Pierce, Jr., *Administrative Law Treatise* § 3.1 (3d ed. 1994) ("It is impossible to draft a statute with sufficient precision and foresight to resolve each of the hundreds of issues that are likely to arise during the life of the statute."); Cass R. Sunstein, *Law and Administration*

after *Chevron*, 90 Colum. L. Rev. 2071, 2088 (1990) ("Congress is unable to amend every statute to account for . . . changes. . . ."). Consequently, it has authorized administrative agencies to implement specific congressional objectives. When Congress delegates authority to an administrative agency, the judicial role is not to pass on the wisdom of an agency's decision, but to assure that the agency has not abused its delegated authority. Davis & Pierce, *supra*, at § 3.3; Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 Duke L.J. 511, 516; Richard J. Pierce, Jr., *Chevron & Its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 Vand. L. Rev. 301, 307-08 (1988); Kenneth W. Starr, *Judicial Review in the Post-Chevron Era*, 3 Yale J. on Reg. 283, 300-04 (1986).

Absent clear indicia of legislative intent, courts often look for guidance to the administrative agency entrusted with the regulation of matters covered by a statute. *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. \_\_\_\_ 115 S. Ct. 810, 813-14, 130 L. Ed. 2d 740, 748 (1995); *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 842-44, 104 S. Ct. 2778, 2781-83, 81 L. Ed. 2d 694, 702-03 (1984); *Blum v. Bacon*, 457 U.S. 132, 141, 102 S. Ct. 2355, 2361, 72 L. Ed. 2d 728, 736 (1982); *Lammers v. Board of Educ.*, 134 N.J. 264, 274 (1993); *Metromedia, Inc. v. Director, Div. of Taxation*, 97 N.J. 313, 327 (1984). In *Nationsbank of North Carolina, N.A.*, *supra*, 513 U.S. at \_\_\_\_ 115 S. Ct. at 813, 130 L. Ed. 2d at 747, the United States Supreme Court recently reiterated:

"It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged

with enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of the banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.' " *Clarke v. Securities Industry Ass'n*, 479 U.S. 388, 403-404, 93 L. Ed. 2d 757, 107 S. Ct. 750, 771-72 (1987) (quoting *Investment Company Institute v. Camp*, 401 U.S. 617, 626-627, 28 L. Ed. 2d 367 91 S. Ct. 1091 (1971)).

In *Chevron*, the United States Supreme Court developed a two-part test for determining whether deference to an agency interpretation of a statute is appropriate. First, the statute that the agency purports to interpret must be unclear. 467 U.S. at 842-43, 104 S. Ct. at 2781-82, 81 L. Ed. 2d at 703. When Congress has not defined an important statutory term, courts fairly can presume that Congress intended the agency to provide a definition. *Id.* at 843-44, 104 S. Ct. at 2782, 81 L. Ed. 2d at 703; *see also* Davis & Pierce, *supra*, at § 3.3 (discussing *Chevron* and presumption of congressional delegation); Scalia, *supra*, at 516-17 (same).

In 1864, Congress may not have contemplated specifically that banks would issue credit cards or even that interest would include late fees. Even so, I believe that Congress intended to delegate to the OCC the authority to implement the goals of the NBA. Also likely, Congress intended that in meeting those goals the OCC would adapt to the changing needs of banks and their customers. That adaptation foreseeably includes administrative changes in the definition of "interest." In brief, I believe that federal banking regulators are in a better

position than state courts to define the meaning of "interest" in the NBA. That conclusion, in my opinion, also represents sound public policy. On a matter so essential to the national economy as the meaning of "interest" in federal banking legislation, the nation is better served by judicial deference to the judgment of Congress and the banking regulators.

The second part of the *Chevron* test directs courts to defer to reasonable agency interpretations. 467 U.S. at 844-45, 104 S. Ct. at 2782-83, 81 L. Ed. 2d at 704; see also *Davis & Pierce, supra*, at § 3.3; *Scalia, supra* at 516-18. Implicit in the notion of reasonableness is discretion in choosing among alternatives. In defining "interest" to include late charges, the OCC has made a reasonable choice among possible definitions of interest. Of course, if Congress should disagree with the agency's interpretation, it retains the authority to redefine the term. See, e.g., *CFTC v. Schor*, 478 U.S. 833, 845-46, 106 S. Ct. 3245, 3254, 92 L. Ed. 2d 675, 689 (1986) (suggesting that Congress's failure to overrule agency supports conclusion that agency definition comports with congressional intent).

The OCC consistently has determined that late-payment and certain other non-periodic fees are interest for purposes of section 85 of the NBA. In a recent interpretive letter, the agency concluded that a federal definition of "interest" under section 85 includes late fees. Letter by Julie L. Williams, Chief Counsel (Feb. 17, 1995), 1995 WL 419824 (O.C.C.). Earlier letters, although relying on the law of the national bank's home state, reached the same conclusion. See Letter by William P. Bowden, Jr., Chief Counsel (Feb. 4, 1992), 1992 WL 136390 (O.C.C.) at \*9-\*11 (concluding that state law determines fees material to

definition of interest) (the Bowden Letter); Letter by Robert B. Serino, Deputy Chief Counsel, Office of the Comptroller of Currency [1988-89 Transfer Binder] *Fed. Banking L. Rep.* (CCH) ¶ 85,676 at 78,063 (Aug. 11, 1988) (same) (the Serino Letter); Letter by Charles F. Byrd, Assistant Director, Legal Advisory Services (May 5, 1986), 1986 WL 143937 (O.C.C.) at \*3 (concluding that state law determines maximum interest rate). But see Letter from Peter Liebesman, Assistant Director, Bank Operations and Assets Division (Feb. 26, 1993), 1993 WL 501557 (O.C.C.) at \*9 (suggesting in *dicta* that late fees are not material to definition of interest absent state law conclusion to contrary). In sum, the OCC consistently has concluded that if a state allows any lender to charge interest in the form of late-payment fees, a national bank located in that state may charge those fees to its out-of-state borrowers.

To confirm that interest, for purposes of the NBA, includes late fees, the OCC recently promulgated proposed Interpretive Ruling § 7.4001 for inclusion in the Code of Federal Regulations. 60 *Fed. Reg.* 11924, 11940 (1995) (to be codified at 12 C.F.R. 7.4001) (proposed March 3, 1995). The proposed ruling states:

The word "interest" as used in 12 U.S.C. 85 includes any payment compensating a creditor or prospective creditor for any extension of credit, the making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, . . . numerical periodic rates, late fees, not sufficient funds fees, overlimit fees, annual fees, cash advance fees, and membership fees.

If adopted, the proposed ruling would further evidence the OCC's conviction that late fees are interest. The majority's cavalier dismissal of the proposed ruling, *ante* at \_\_\_ (slip op. at 22), fails to consider the ruling's significance.

The agency's definition of "interest," as expressed in its interpretive letters, is clear. The judicial task is to determine whether that interpretation is reasonable. *Nationsbank, supra*, 513 U.S. at \_\_\_, 115 S. Ct. at 813, 130 L. Ed. 2d at 748; *Chevron, supra*, 467 U.S. at 843-44, 104 S. Ct. at 2782-83, 81 L. Ed. 2d at 704. In its February 17, 1995, interpretive letter, *supra*, the OCC documented early federal case law that defined "interest" as the "compensation allowed by law, or fixed by the parties, for the use or forbearance of money, or as damages for its detention." *Brown, supra*, 82 U.S. (15 Wall.) at 185, 21 L. Ed. at 131. The letter then concludes that late-payment fees, which legitimately compensate lenders for increased lending costs and risks associated with delinquent borrowers, are interest.

The OCC's conclusion is reasonable. It permits a national bank to charge any fees related to the use of money, if those charges are authorized by the bank's home state. That concept of parity comports with the NBA's goal of preventing discrimination against national banks. No principled reason confines the NBA to periodic interest rates.

Contrary to the protestations of the majority, *ante* at \_\_\_ (slip op. at 22-26), the evolution of the OCC's analysis does not render its opinion unworthy of judicial deference. *Chevron* counsels that an agency's change in a policy

determination is not necessarily entitled to less respect because of the change. *See* 467 U.S. at 863-64, 104 S. Ct. at 2792, 81 L. Ed. 2d at 715-16; *Scalia, supra*, at 517-19 (discussing *Chevron's* rejection of consistency requirement); *Starr, supra*, at 297-98 (same). Although the agency's analyses may have evolved over time, the analytical path has consistently led to the conclusion that national banks may export late fees. Late charges, moreover, are sufficiently close to the essence of "interest" to justify the OCC's decision to include them within the meaning of the word. The prototypical definition of "interest" as periodic interest is broad enough to encompass late charges. *See generally* Lawrence M. Solan, *Judicial Decisions and Linguistic Analysis: Is There a Linguist in the Court?*, 73 Wash. U. L.Q. 1069 (1995) (discussing definitional and prototypical interpretations of statutory language). I accept the conclusion of the banking regulators that interest for purposes of the NBA may include late charges and other fees charged by lenders in connection with a loan.

-IV-

-A-

Having determined that section 85's definition of "interest" includes late fees, the next question is whether that definition preempts the RISA's prohibition against the imposition of such fees. More specifically, the question is whether Congress intended that the NBA, as interpreted by the OCC, should preempt state law.

Congress may preempt a state law by expressly stating that it so intends, *e.g.*, *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, \_\_\_, 112 S. Ct. 2608, 2617, 120 L. Ed. 2d 407,

422-23 (1992); by occupying an entire field of regulation, e.g., *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 1152, 91 L. Ed. 1447, 1459 (1947); or by enacting a federal statute that conflicts with a state law, *Hillsborough County, supra*, 471 U.S. at 713, 105 S. Ct. at 2375, 85 L. Ed. 2d at 721; *Maryland v. Louisiana*, 451 U.S. 725, 747, 101 S. Ct. 2114, 2129, 68 L. Ed. 2d 576, 596 (1981).

Section 85 does not contain an express preemption clause. Given the dual regulation of banking by state and federal regulators, Congress may not have occupied completely the field of banking regulation. The question becomes whether section 85's definition of "interest," which permits national banks to impose late fees, conflicts with the RISA's prohibition of such fees.

My analysis begins with the Supremacy Clause of the United States Constitution:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

[U.S. Const., art. VI, cl. 2.]

Ever since *Gibbons v. Ogden*, the Supremacy Clause has mandated preemption of state laws that "interfere with, or are contrary to the laws of Congress. . . ." 22 U.S. (9 Wheat.) 1, 6 L. Ed. 23 (1824). Notwithstanding the supremacy of federal law, the United States Supreme Court has "never assumed lightly that Congress has derogated state regulation, but instead [has] addressed claims

of pre-emption with the starting presumption that Congress does not intend to supplant state law." *New York Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. \_\_\_, 115 S. Ct. 1671, 1676, 131 L. Ed. 2d 695, 704 (1995); see *Maryland, supra*, 451 U.S. at 747, 101 S. Ct. at 2129, 68 L. Ed. 2d at 595; *Rice, supra*, 331 U.S. at 230, 67 S. Ct. at 1152, 91 L. Ed. at 1459. The Court, however, has found conflict to be preemptive when "compliance with both federal and state [laws] is a physical impossibility." *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43, 83 S. Ct. 1210, 1217-18, 10 L. Ed. 2d 248, 257 (1963). It likewise has recognized preemption of state law when that law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67, 61 S. Ct. 399, 404, 85 L. Ed. 581, 587 (1941). Preemption is not foreclosed, however, merely because a federal statute displaces a traditional subject of state regulation. See *Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta*, 458 U.S. 141, 153, 102 S. Ct. 3014, 3022, 73 L. Ed. 2d 664, 675 (1982); *Greenwood Trust, supra*, 971 F. 2d at 828. To constrict unduly a federal statute to avoid interference with a state law would subvert the Supremacy Clause.

Against that background, the question recurs whether section 85, which permits a national bank to impose a late fee, and the RISA, which prohibits such a fee, are in conflict. In one sense, to state the question is to answer it. When state law prohibits an act that federal law permits, the conflict is apparent. True, section 85 does not mandate that national banks must charge late fees. The problem arises only when the national bank seeks to impose a late fee. By foregoing late fees, Citibank could

avoid the conflict. That analysis, however, begs the question.

As with ascertaining the meaning of "interest," I find guidance on the question of preemption in the rulings of the OCC. In her February 17, 1995, letter, *supra*, OCC Chief Counsel Julie Williams ruled:

[W]e reaffirm our previous conclusion that "interest" permitted under section 85 may be charged without reference to whether all or part of it is permissible under the laws of the state where the customer resides. If the law of the state where the customer resides is different from the law of the state in which the bank is located, the former law has no effect on what the bank may charge as "interest."

Accord the Bowden Letter, *supra*; the Serino Letter, *supra*; see also Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 92-47, *Fed. Banking L. Rep.* (CCH) ¶ 81,534 at 55,730-31 (July 8, 1992) (reaching same conclusion under section 521); Letter by Douglas H. Jones, Deputy General Counsel, FDIC No. 93-27, *Fed. Banking L. Rep.* (CCH) ¶ 81,635 at 55,838-39 (July 12, 1993) (same).

Admittedly, an agency statement according a preemptive effect to a statute is not as persuasive as an express statutory clause. Given the pervasive role that Congress has entrusted to federal banking regulators, however, I would respect consistent regulatory rulings on preemption. *City of New York v. FCC*, 486 U.S. 57, 64, 108 S. Ct. 1637, 1642, 100 L. Ed. 2d 48, 57 (1988) ("[I]f the agency's choice to pre-empt 'represents a reasonable accommodation of conflicting policies that were committed to the agency's care . . . , we should not disturb it

unless it appears . . . that the accommodation is not one that Congress would have sanctioned.' ") (quoting *U.S. v. Shimer*, 367 U.S. 374, 383, 81 S. Ct. 1554, 1560, 6 L. Ed. 2d 908, 915 (1961)).

Federal supremacy in the regulation of credit-card interest charges also makes sense. In many respects, credit cards have replaced the national currency. Residents of one state regularly make credit-card purchases from mail-order retailers in other states. Similarly, they use credit cards to charge meals, lodging, transportation, and other expenses when traveling throughout the nation and the world. Credit cardholders, moreover, can change their state of residence. Given the mobility of credit cardholders and transactions, federal regulation incorporating a bank's home-state's law is reasonable. The majority recognizes as much. It writes: "The theory of the NBA, as applied by federal and state courts, is that the borrower's state usury laws can be discarded because the customer either taking out a loan or using her 'lender credit card' partakes in a transaction in the national lender's home state." *Ante* at \_\_\_ (slip op. at 37).

-B-

Close analysis of New Jersey law, moreover, reveals that the RISA impermissibly interferes with the congressional goal of preventing states from discriminating against national banks. *Tiffany, supra*, 85 U.S. at 412-13, 21 L. Ed. at 863-64. Although the RISA prohibits certain lenders from imposing late fees on delinquent borrowers, various statutory provisions expressly authorize other lenders to charge such fees. For example, *N.J.S.A.*

17:13-104b expressly authorizes credit unions to charge late fees: "A credit union may charge late fees . . . not to exceed 20% of the principal balance and interest outstanding. . . ." Similarly, N.J.S.A. 17:16C-42(b), L. 1995, c. 43, § 1, as recently amended, provides that "[t]he holder of any retail charge account may collect a delinquency or collection charge in an amount not to exceed \$10. . . ." Moreover, N.J.S.A. 17:9A-59.7 authorizes banks to charge late fees on advance loans. Thus, some New Jersey lenders are authorized expressly to charge late fees.

In 1981, the New Jersey Legislature enacted the State Bank Parity Act (the Parity Act), N.J.S.A. 17:13B-1 to -2, which is modelled after section 85. The Parity Act provides: "Notwithstanding any . . . statute to the contrary, any bank, savings bank, savings and loan association or credit union may charge a rate of interest . . . permitted to any other lender by the laws of this State. . . ." N.J.S.A. 17:13B-2.

If late fees are interest under the Parity Act, then any New Jersey bank may charge them. On that premise, the RISA would prohibit only national and out-of-state banks, such as Citibank, from charging late fees. That result would discriminate against out-of-state national banks that lend money to New Jersey borrowers. A state law that discriminates against out-of-state national banks conflicts directly with Congress's goals, and, therefore, is preempted.

The possibility of that conflict raises the question whether late fees are "interest" for purposes of the Parity Act. Title 17, which governs financial institutions, does not expressly define the term. The relevant New Jersey

statutes send inconsistent signals on the question whether the definition of interest excludes late fees. For example, N.J.S.A. 17:13-104(b), the same provision that authorizes credit unions to charge late fees, also authorizes credit unions to charge interest. Similarly, holders of retail charge accounts may charge interest under N.J.S.A. 17:16C-40 and late fees under N.J.S.A. 17:16C-42. Furthermore, N.J.S.A. 17:9A-59.6 discusses interest rates on advance loans, and N.J.S.A. 17:9A-59.7 authorizes late fees on those loans.

Although New Jersey statutes apparently distinguish annual interest and late fees, I cannot ignore the Legislature's unequivocal statement that it enacted the Parity Act as a corollary to section 85. The Assembly Banking and Insurance Committee Statement that accompanied the Parity Act declared that the Act

would give state chartered banks, savings banks, savings and loan associations, and credit unions the same "most-favored-lender" authority that national banks presently enjoy. By the provision of 12 U.S.C. 85, national banks may take interest at the rate allowed by the laws of any state. . . . The [OCC], who supervises national banks, has interpreted this to mean that national banks may charge interest not only at the rate permitted by state law to banking institutions, but also at the rate for a similar type of loan made by any licensed lender. . . . This legislation, therefore, provides [similar] parity to state-chartered institutions.

In the Parity Act, the Legislature intended to grant state banking institutions the same benefits that national banks enjoy under the NBA, as construed by the OCC. Under

the Parity Act, therefore, state banks, like national banks, may charge late fees as interest.

The New Jersey Department of Banking has concluded that because late fees are interest under the NBA, they are interest for the purposes of the Parity Act. See Letter from Francis P. Carr, Assistant Commissioner, Department of Banking (Oct. 14, 1994). Although informally expressed, the assistant commissioner's letter is the department's only expression of its understanding of the meaning of interest in the Parity Act. Both the state and federal legislative schemes rely on regulation by administrative agencies. Because the Legislature has entrusted the department with the regulation of state banks, the department's interpretations of state banking laws are entitled to judicial deference. *Lammers, supra*, 134 N.J. at 274.

Admittedly, the Legislature has not drawn distinct lines; it could have expressed its intent more definitively. We are remitted to finding the Legislature's intent in a statutory mosaic. The majority sees one picture. I see another.

I conclude that the definition of interest in the Parity Act includes late fees. Under the Parity Act, because credit unions and retailers may charge late fees, "any bank, savings bank, [or] savings and loan association" chartered in New Jersey also may charge such fees.

Because state-chartered banks may charge late fees to New Jersey customers, a state law, such as the RISA, that prohibits out-of-state national banks from charging such fees would constitute impermissible discrimination in

violation of the Supremacy Clause. In sum, I would hold that the NBA conflicts with, and thus preempts, the RISA.

-V-

Interestingly, the majority concludes that in the future out-of-state national banks may impose limited late-payment fees on New Jersey cardholders. The Court so concludes because the 1995 amendment to *N.J.S.A. 17:16C-42,L.* 1995, c. 43, § 1, extends the right to charge late fees of up to \$10 to holders of retail charge accounts. For me, however, the source of a national bank's authority to impose late fees is not the RISA, but the NBA. By declaring that the RISA determines the amount of the late fee that a national bank may charge, the majority has inverted the Supremacy Clause so that state law trumps federal law. The need for uniform regulation of national banks, not misplaced notions of federalism, should prevail.

Ultimately dividing the majority and dissent are differing perceptions of the roles of Congress, federal banking regulators, and state courts in regulating national banks. The majority takes a position reminiscent of states'-rights advocates who opposed federal regulation of interstate commerce and of national banks. Banking, however, is integral to the national economy. Credit cards and other innovations such as electronic money transfers have converted consumer lending from a local to a national activity. In that context, the need for federal control is paramount. Until such time as Congress explicitly determines whether interest includes late charges, I would defer to the judgment of the OCC.

My colleague, Justice O'Hern, reaches the same result as do I, but through a different analysis. He proceeds from the major premise that the NBA expresses a general congressional intent, apart from the terms of the statute, that states must not favor state banks over national banks. *Post* at \_\_\_ (slip op. at 1). His minor premise is that New Jersey law permits lenders to impose late charges as interest. *Id.* at \_\_\_ (slip op. at 4). From this, he concludes that by permitting New Jersey banks, but not national banks, to impose such charges, New Jersey law violates the NBA.

My problem with his analysis is with its divination of congressional intent apart from the terms of the statute. For me, the reason that the NBA trumps RISA is that section 85 expressly permits national banks to charge "interest at the rate allowed by the laws of the State . . . where the bank is located." "Interest," as previously explained, includes late charges. Close examination of the authorities cited by Justice O'Hern reveals that they rely not on metaphysical notions of congressional intent, but on the specific words of the statute. *Post* at \_\_\_ (slip op. at 3-4). I also find misplaced his concern that Congress did not intend states to "export" their "consumer protection attitudes" to other states. *Id.* at \_\_\_ (slip op. at 7).

The mischief hides in the term "export." When a South Dakota national bank charges interest, including late fees, as allowed by that state to a borrower in New Jersey, the charge is legal because the NBA expressly allows it, not because South Dakota is "exporting" its interest rate to New Jersey. The authority for the imposition of the charge is not South Dakota law, but the NBA.

Congress has defined the standard to measure the allowable rate of interest; that standard is interest as allowed by the national bank's home state. As Citibank's home state, South Dakota merely provides the point of reference. Only in a metaphorical sense is South Dakota "exporting" its rate of interest. In reality, a national bank may impose interest as allowed by its home state because Congress has so ordained.

For the preceding reasons, I respectfully dissent.

Justice Garibaldi joins in this dissent.

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SUPREME COURT OF NEW JERSEY  
A-102 September Term 1994

MARC SHERMAN, on behalf of himself  
and all others similarly situated,

Plaintiff-Appellant,

v.

CITIBANK (SOUTH DAKOTA),  
N.A.,

Defendant-Respondent.

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O'HERN, J., dissenting.

I agree with the majority that the National Bank Act does not preempt state consumer protection laws that prohibit late charges on credit card accounts. I would, however, allow national banks to assess late charges against credit card holders in New Jersey, not because the late charges are interest under the National Bank Act (they are not) and not because Congress has authorized the Comptroller of the Currency to preempt the State's consumer protection law, but because New Jersey law permits lenders to impose such late charges and may not discriminate against national banks that seek to impose the same charges.

In 1864 Congress enacted the National Bank Act, c. 106, 13 Stat. 99 (NBA). Section 85 of the NBA now provides that any national bank

may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest at the rate allowed by the laws of the State \* \* \*

where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater \* \* \*

[12 U.S.C.A. § 85.]

In addition to addressing interest rate differentials between state and national lending institutions, the NBA had a more profound purpose and effect – to assure that national banking institutions were never put at any economic disadvantage in competition with state-chartered institutions.<sup>1</sup>

Before the Civil War, Jacksonian distrust of concentrated power of mercantile interests had brought about the demise of national banks and the rise of the state banking systems. *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 413, n.5, 107 S. Ct. 750, 764, n.5, 93 L. Ed. 2d 757, 777, n.5 (1987) (Stevens, J., concurring).

Enactment of the National Bank Act was part of Congress's attempt to induce state-chartered banks to convert to national charters in order to achieve several federal objectives, such as the development of a national currency, the creation of a market for federal bonds to finance

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<sup>1</sup> Sections 521 through 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96221, 94 Stat. 132, authorize other federally insured depository institutions to collect interest as allowed by the laws of the state in which they are located. Those provisions generally confer on federally insured state banks the privileges that national banks enjoy under the NBA. For convenience of analysis, I refer only to the federally chartered institutions.

the war, and the use of the national banks as depositories.

[Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 *Geo. Wash. L. Rev.* 676, 699 (1983).]

If state-chartered banking institutions were permitted to make loans on more favorable terms than nationally chartered institutions, then nationally chartered institutions would be at an economic disadvantage. Congress "deliberately settled upon a policy intended to foster 'competitive equality' " between national banks and state banks. *First Nat'l Bank in Plant City, Fla. v. Dickinson*, 396 U.S. 122, 131, 90 S. Ct. 337, 342, 24 L. Ed. 2d 312, 318 (1969) (quoting *First Nat'l Bank of Loan, Utah v. Walker Bank & Trust Co.*, 385 U.S. 252, 261, 87 S. Ct. 492, 497, 17 L. Ed. 2d 343, 349 (1966)). In the *Walker Bank* case, involving branch banking issues, the Court wrote: "To us it appears beyond question that the Congress was continuing its policy of equalization first adopted in the National Bank Act of 1864." 385 U.S. at 261, 87 S. Ct. at 497, 17 L. Ed. 2d at 349 (emphasis added).

Because equalization, not preemption, is the congressional policy, New Jersey cannot grant late-charge privileges to its financial institutions and not to national banks:

The purpose of section 85 is [1] to adopt the state law, relating to interest rates permitted, to permit national banks to charge the rate of interest allowed to competing lenders in the state, and [2] to guard against unfriendly federal-state legislation or ruinous competition with state

chartered or licensed lenders. This interpretation of Section 85, commonly referred to as "the most favored lender policy" puts national banks on an equal footing with the most favored lenders in the state without giving them an unconscionable and destructive advantage over all state lenders. The statute prevents state legislation which purports to give state banks or possibly any state lender advantages over national banks.

[*United Missouri Bank of Kansas City, N.A. v. Danforth*, 394 F. Supp. 774, 779 (W.D. Mo. 1975) (emphasis added).]

The New Jersey Department of Banking reasons that state-chartered credit unions "are authorized to offer credit cards and charge late charges without limit." (Letter from Francis P. Carr, Assistant Commissioner, New Jersey Department of Banking, to Dennis R. Casale 1 (Oct. 14, 1994) (citing N.J.S.A. 17:13-105(c)). Thus, even though late charges are not interest, a national bank must be permitted to impose late charges as long as a state lender may impose them. See *Saul v. Midlantic Nat'l Bank/South*, 240 N.J. Super. 62, 81 (App. Div.) (recognizing that under "most favored lender" doctrine, national banks may make loans on same terms as state-chartered credit union), *certif. denied*, 122 N.J. 319 (1990).

In addition, S. 1412, signed into law on March 7, 1995, amended the Retail Installment Sales Act (RISA), N.J.S.A. 17:16C-1 to -61, the statute on which plaintiffs have based their claims in this case. The 1995 amendment expressly authorizes the holder of any retail charge account to collect flat late charges. N.J.S.A. 17:16C-42. After that amendment there can be no question that a

nationally chartered credit card lender may not impose such late charges, at least to the extent allowed under S. 1412. Were it otherwise, Citibank explains, there would be favoritism shown to state lenders:

The favored lender, by contracting for flat, contingent charges from late payers, can protect itself against risks and costs associated with delinquencies while keeping monthly percentage charges low to attract good customers who are consistently punctual. The disfavored lender, who cannot collect late charges, tends to get all the customers who anticipate paying late and tends to lose the customers with strong credit and habits of punctuality because it must impose higher monthly percentage charges to make up for its inability to impose late charges.

That competitive advantage cannot be given to the state-chartered institutions. *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855, 863 (6th Cir. 1972), held that because a Michigan-chartered savings and loan association was permitted to charge a borrower (in addition to interest) the closing costs of a real estate loan, a national bank could legally impose such additional charges. The *Northway Lanes* court quoted a principal drafter of the NBA, Senator John Sherman of Ohio, who explained that the purpose of the NBA was "to confer on these national banks the same privileges that are conferred by the laws of the States on other associations and individuals . . . [and] to place the national banks in each state on precisely the same footing with individuals and persons doing business in the state by its laws." 464 F.2d at 861 (quoting *Cong. Globe*, 38th Cong. 1st Sess. 2126 (1863)).

"National banks have been national favorites." *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409, 413, 21 L. Ed. 862, 864 (1874). The NBA confers on them "at least competitive equality" with other lenders and a "possible advantage over state banks in the field of interest rates." *Fisher v. First Nat'l Bank of Omaha*, 548 F.2d 255, 259 (8th Cir. 1977) (emphasis added). No state may create a competitive disadvantage by favoring any class of state lenders over national lenders, as New Jersey would favor its state lenders if they alone can impose late charges. An Opinion Letter from the Office of the Comptroller of the Currency explains:

[I]f a state allows state banks to charge credit card annual fees at flat rates, then section 85 allows national banks to do so as well. If national banks were not allowed to match state-regulated lenders on these flat loan charges, then the "most favored lender" principle would be destroyed.

[Letter from Julie L. Williams, Chief Counsel, to John L. Douglas (Feb. 17, 1995), 1995 WL 71676 (OCC), \*6.]

Plaintiffs seek to avoid the application of the "most favored lender" doctrine by arguing that The Credit Union Act, N.J.S.A. 17:13-73.1 to -125, did not always authorize unlimited late fees on retail charge cards, insisting that the more specific provisions of RISA controlled retail credit card transactions. Plaintiffs' interpretation of the law is of little consequence as long as the State regulators continue to permit state-chartered lenders to impose late charges. The NBA forbids precisely that form of discrimination against national banks.

States have a profound interest in their consumer protection laws. *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 314, 99 S. Ct. 540, 548, 58 L. Ed. 2d 534, 545-46 (1978), held only that "interest rates of one State [can be] 'exported' into another" because a literal application of the plain language of "rate allowed" in Section 85 compelled that result. Only a distorted reading of Section 85 would allow exportation of the consumer protection attitudes of the home state of the national bank. See William G. Bornstein, Comment, *Extension of the Most Favored Lender Doctrine Under Federal Usury Law: A Contrary View*, 27 Vill. L. Rev. 1077, 1107-08 (1981-82) (analyzing the *Marquette* holding).

I cannot imagine that Congress intended that South Dakota or Delaware be permitted to export their concepts of consumer protection and to preempt and nullify the consumer protection laws of New Jersey. I therefore agree with that portion of the Court's opinion.

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